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A MESSAGE FROM THE PRESIDENT

To be president of The American Association of University Instructors in Accounting is at the same time an honor, a privilege, and a responsibility. It is a great honor and a high privilege to follow in the footsteps of that illustrious group, the members of which have in the past twenty years served year by year as presidents of this Association. It is also a distinct responsibility to attempt to measure up to the records of these men in their administration of the Association's affairs. It is my hope and it will be my endeavor that this, the twentieth year of the Association's activities, shall compare favorably with those that have passed. May it be a milestone dividing the twenty years that have gone, from the more than twenty years that are to come.

The Association serves its members, takes its place in the accounting profession and stands as an intellectual force in modern society in large part through its contributions in its publication, the ACCOUNTING REVIEW. *Under the present editor and his staff the* ACCOUNTING REVIEW *is becoming a recognized constructive force in the affairs of the accounting world. This year the* ACCOUNTING REVIEW *should go even further by adding to the quantity of material within its covers and by increasing its circulation and use throughout the country. At the 1934 executive committee meeting the Editor expressed the hope that additional funds might be made available for such expansion and improvement. These funds can come from two sources: increased membership in the Association and increased circulation for the* ACCOUNTING REVIEW. *The officers of this administration will work toward this end.*

It is not surprising that the number of members in the Association has been slightly decreasing for the last three years in spite of the efforts of the membership committee. It is time that the direction of this trend would change. The morale of the organization and the proposed expansion of its activities demand additions to its membership. Professor Harvey G. Meyer, Chairman of the Membership Committee for the past five years is planning to conclude his second term and at the same time become an active first vice-president by directing an extensive campaign for increased membership. This campaign will be successful only with the personal assistance of every member. It is your responsibility to see that the Association's membership is increased by a material amount. If this is done the administrative program for 1935 will be assured success.

The annual conventions of the Association have always been held as high places in its history. At these conventions university intsructors in accounting assemble for formal and informal discussion of their problems. For these meetings the president of the Association is directly responsible. It is my pleasure to announce that already I have received written promises from the following stimulating members of this Association to appear on the program in December 1935. My own colleague in the University of California at Berkeley, Professor Henry R. Hatfield, and the instructor who taught me accounting at Harvard, Professor Emeritus William Morse Cole, have signified their willingness to appear on the program. Professors Roy B. Kester and William A. Paton, Dean J. Hugh Jackson and Mr. James O. McKinsey, former presidents of this organization, have agreed to furnish papers. In addition to these, such well known and respected writers and thinkers in the field of accounting, as Professors A. C. Littleton, Stanley E. Howard and Thomas H. Sanders will have subjects for your consideration.

The 1935 program of the American Association of University Instructors in Accounting is just beginning. That it may have a successful conclusion, the coöperation of each and every member is essential. If you will give of your talents to that phase of the program for which you are best fitted the proposed plans will become accomplished facts.

H. S. NOBLE

PROBLEMS OF ACCOUNTING INSTRUCTION

OBJECTIVE TESTS IN ELEMENTARY ACCOUNTING

GEOFFREY CARMICHAEL

MEMBERS OF the faculty of the accounting department at Indiana have come to the conclusion that they want to be judged by the number of students who successfully pass the course rather than by the number who fail to pass. The elementary-accounting course is a four-semester-hour course, running through both semesters of the freshman year. The classes meet twice a week for one hour each time, and there are no laboratory or directed study periods between recitations. The freshman course is followed by a six-hour sophomore course, which is really quite a jump from the work of the first year. The sophomore work presupposes almost complete mastery of the fundamental principles of debit and credit, account and statement classification, and the common knowledge required for closing a set of books.

Our freshman classes regularly have from forty to fifty students, which number, coupled with only two recitations a week, almost precludes the possibility of very much class discussion. Naturally with such a set-up as this it becomes necessary to give considerable attention to teaching methods if we are to get the subject across to the majority of the students. Some method of measuring achievement becomes necessary. It is not fair to the student to wait until mid-term or the end of the semester to inform him of his class standing. For the past two years we have been experimenting with the short objective test.

An explanation of the term *objective test* is desirable. This type of test has for its purpose the covering of many items; the answers required are brief; and there is only one correct answer to each item. This test is often called the *new type* test to distinguish it from the traditional essay or discussion type test.

I want to make it clear that we are not using these tests for the purpose of teaching the subject matter. The actual instructional effort is placed on the lecture-discussion periods and through carefully graded problems which are assigned with each unit of work. These problems are either discussed in class or corrected outside of class and returned to the students. Experience has proved that it is not fair to give weight toward the final mark for the outside preparation. The work of elementary accounting is divided into the customary units of the balance sheet, profit and loss statement, the account, special journals, etc. After each unit is completed, a short objective test is given.

The objective test serves four distinct ends: (1) motivation; (2) diagnosis; (3) semester marks; and (4) student classification. Motivation is the essence of successful teaching in any course. The most desirable motivation is the natural interest in the subject itself, but we cannot rely on this when a great many students are taking the subject because it is required. For the same reason the instructor's personality, while of vital importance, cannot reach the interest of everyone. However, the objective test at the end of each unit serves to keep at least 90% of the freshman group actively working for mastery of the subject matter. While the test may be considered as an artificial type of motivation we feel that if we can from the very beginning keep the student working we have rendered him a real service.

As a diagnostic device the tests are an aid to the instructor and to the student. There are enough items included in each unit test to make sure that the entire material is covered. The papers are marked and the different questions are analyzed as to the number of times they are missed. In this way it is possible to discover what problem or problems need reteaching. The student is able to see what he has mastered and what he needs to put more effort on. After two or three of these objective tests, if he does not do so well, the student usually asks for a conference and in this conference decides on a plan for improving his standing.

The burden of issuing correct marks is

greatly lessened by the frequent quizzes in that a reliable objective result is determined by the student in his repeated opportunities on the unit tests. Originally we attempted to give credit for every problem that was prepared outside of class. Here the problem always arose as to the justice of an "A" mark on an assigned problem, when the same student "flunked" a test over identical material. After trying to arrive at some manner of correct weighting the outside preparation and failing, we have come to the conclusion that in fairness to all we will give credit only for tests completed in the classroom. In addition to the frequent ten-minute objective quizzes we also give a long examination (objective type) at mid-term and at the end of the semester. Results show that only a very few students change their standing by these longer tests, but tradition seems to require a mid-term and university requirements demand a final examination.

For the purpose of student classification (the fourth end mentioned above) a much longer objective test is used. This classification test is for those students entering our course who have had a year or more of bookkeeping in the Indiana high schools. We receive each fall approximately 350 beginning students of whom more than fifty have had a year or more of bookkeeping. Until very recent years, high-school bookkeeping did not seem to aid the freshman student. However, there is a noted change in the achievement of the high school student in bookkeeping. Three definite reasons may be given for the change. First, every year there is a state commercial contest in which bookkeeping students compete. We always get several of the contestants; a second reason is that the textbooks that have been written or revised within the last few years have shown a distinct improvement in the method of presentation of material. A third and very important reason for the better showing is that the teacher training requirements have been materially increased. In the larger cities, the teacher has had four years of business education and in many cases a year's graduate study in a business school.

To force or permit entering students with two semesters or more of high school bookkeeping credit to take the freshman course in accounting gives them an opportunity to slip through their first courses with very little effort. It also deprives the ambitious student from taking such elective courses as he would choose in preference to the required accounting.

To meet this situation an entrance examination is given, which covers the first semester of our course. If the student does reasonably well, he is exempted from one semester's work; if he does exceptionally well he is given a test over the second semester's work and if he does this satisfactorily, he is allowed to enter the intermediate course. Incidentally, of all the students exempted from one or two semesters all but one have made a grade of "B" or "A" in their university accounting courses. This one student made a "C plus."

The main principle in the preparation of the objective test is to frame each question so that there can be only one correct answer. The short-test material is taken directly from the textbook and lecture material which has just been completed in class discussions. An attempt is made to include all items which have been discussed in the unit.

The longer tests used for classification of entering students are prepared just a little differently. The material for these tests is validated by a study of our own teaching materials and also from the textbooks that are in use in the high schools throughout the state. In this way we are sure to include the terminology that is familiar to the student. The test is long enough to insure that all units taught in our elementary course are included. In order to be sure that our results are reliable we have checked the odd items of the test against the even and have secured a reliability coefficient of above .90.

A key is prepared with accuracy for our student paper-graders.

We have not used many of the published objective tests because these tests have for the most part, been prepared for use with a specific textbook. We have not attempted to standardize our own tests because we are

experimenting and changing from semester to semester.

A number of criticisms have been made against the objective tests but I believe those criticisms have been offered by persons not thoroughly acquainted with their possibilities. A common objection is that they stifle the student's creative ability—that they are responsible for poor English and limited vocabularies. When you consider that the total time consumed in taking any kind of test in any course is minor when compared to the total time spent on the entire course, this criticism cannot be justified. All necessary attention to expression and English can come from the remainder of the work in the course. A second criticism is that it encourages cheating. It is true that a student can glance at his neighbor's paper and find the short answer but our experience has been that only a few will do this and these can soon be singled out and easily taken care of. A third criticism is that the tests are hard to prepare. It does take time and experience to prepare them but the time saved in marking compensates many times for the extra effort in preparation. Another criticism is that this kind of test places a premium on memory. There are certain things in the elementary course that must be memorized and if this type of test will facilitate this memorization certainly it cannot be condemned. However, our tests are so prepared that the same type of reasoning must be called forth as if it were the essay or problem type of test.

One of the chief advantages is that the objective test may be accurately graded by student assistants. A second advantage is that it is possible to get away from expressing the total value of the test in terms of 100%. If we could make subjective or objective tests absolutely perfect we might be sure of the percentage weight to give to each part. Experience has repeatedly shown that no two persons will mark a subjective test and give it exactly the same percentage weight. The objective test is marked in points. The student with the most points right receives the "A" or high mark; the remainder of the grades are expressed in relation to the highest mark. We do not follow any theoretical distribution but the grades do follow with little variation a fairly normal distribution. A third advantage is in the amount of time saved. In ten minutes' time a complete test on the Balance Sheet can be finished; if the student were asked to prepare a Balance Sheet he would be only well started in the same length of time. The outstanding advantage is that the marks are absolutely objective. An individual who had never studied accounting would get the same result in marking a test as would be obtained by the accounting instructor.

By using the objective test it is possible to give more frequent tests and thus inform the student early in the course and repeatedly during the course of his achievement. The student is able to adjust himself to the course requirements without waiting until the mid-term or final examination when it is too late for adjustment. The instructor is relieved from the responsibility of issuing a subjective mark for the student's final grade, for he has objective facts, reliable and valid, on which to base his grades. Finally, more students are guided from the beginning to a successful completion of the freshman course in elementary accounting.

THE TEACHING OF ELEMENTARY ACCOUNTING

R. E. Glos

Because it might be contended that this paper is attempting to make a virtue out of necessity or rationalizing that which had to be, let me say that the system of teaching accounting at Miami University was inaugurated before restrictive legislative appropriations might have forced the same system on us. Furthermore, because of the latter factor, it may be that what we are doing is not now as unique as it might have been some years before. Perhaps I am laboring under a delusion in believing there is or ever was anything unique in our methods.

Miami University offers a total of six hours of credit in elementary accounting, three hours each semester. A student must have attained sophomore rank to be eligible

for enrollment. All students take the same course regardless of whether they are accounting majors, business students interested in other majors, or students in other divisions of the University taking the course for various reasons. Specific examples of the latter are School-of-Education majors in commercial subjects and prelaw majors in the College of Liberal Arts.

Our system, for want of a better title, might be called the "lecture-quiz-lab" method of presentation. In order to describe this more accurately let me take the liberty of presenting our present situation somewhat in detail. We have approximately 180 students enrolled in elementary accounting this fall. At the start of each week they meet as a unit for a one-hour lecture period. They are then divided into quiz sections of approximately thirty students, each section meeting for a class-hour period. Two quiz sections are then combined into a laboratory group of about sixty students. These laboratory periods are two hours in length. If you have followed the figures you will have noted that we operate one lecture period, six quiz sections, and three laboratory groups. The quiz sections are arranged in groups of two, one followed by another. This works out something as follows: The student has his lecture Tuesday morning at nine o'clock. He then chooses, let us say, Section A quiz class at 8 o'clock Thursday morning or Section B at 9 o'clock the same day. Sections A and B combined meet Saturday morning from eight until ten o'clock for their laboratory period.

With this general introduction I should like to dwell more at length on the function, as we see it, of the three divisions of the organization.

Lecture. The lecture opens the new topic for the week. The student has made no preparation, in fact the text assignment is not given out until the lecture period. The lecture is in the nature of a blackboard talk, generally following the text, but attempting to do what a text cannot do adequately: that is, show the "build-up" of the subject. For example, a text in describing a trial balance can illustrate only a completed ledger and a completed trial balance, while in lecture it is possible to show the detailed construction of both. The student is required to take notes which are turned in twice each semester for grading. On occasion the lecture has been used to give an examination of the objective type using true-false and completion type of questions.

Quiz. Before appearing in the recitation room the student is supposed to study the text material and his lecture notes. In order to insure that this is done, frequent ten-minute quizzes are given. These cover the new material, and usually at least one question is asked the answer to which is in the text but was not discussed in the lecture. The remainder of the hour is taken up with questions and answers, going over the previous week's problems, going over examinations, and other normal uses of a recitation period.

Laboratory. The problem or problems for the week are announced at the opening of the period and the proper type and amount of paper is passed out to each student. He then spends two hours starting his solution under the direction and supervision of the instructor. The problem assignment is usually of sufficient length so that an additional two to three hours is required to complete the work, which must be turned in at the lecture period following. No sets are used. The laboratory session is also used for examinations, usually four a semester. These are problem-type examinations of two hours' duration.

Some of the advantages of this system are:

1. Economical from point of view of teaching hour load.
2. Standardizes presentation to various quiz sections.
3. Offers possibilities of group examinations during semester.
4. Offers opportunity for thorough problem examinations.
5. Affords opportunity for extensive problem material.
6. Insures some individual problem work on the part of each student.

Whatever disadvantages the system may

have are probably bound up in the inherent weaknesses of the lecture system as applied to any course. My own feeling is that not many over 150 students can adequately be taken care of in a lecture room where blackboard work forms the major part of the lecture proper.

Before closing I should like to itemize some of the minor things we do which seem to make for effective teaching but which perhaps are not in common use:

1. Furnish students with all paper used in solution of problems. This is bought out of a laboratory fee collected from each student in the fall.
2. Return all quizzes and laboratory examinations to the student the following recitation period and explain the solution.
3. Attempt to return all problems graded at the following recitation period, with errors noted.
4. Have all problems and examination papers returned for our files rather than those kept by fraternity houses.
5. Make use of colored chalk to show certain entries in ledger accounts, for example, adjusting and closing entries. Our success with this would seem to warrant its more extensive use in the future.
6. Provide laboratory with adding and calculating machines which students may and are urged to use as much as possible.
7. Make use of a mathematical base for final grades which is announced to students at the opening of the course. Our base involves weighted figures for the final examination, hour examinations, short quizzes, problems, and lecture note grades.

A DILEMMA IN TEACHING ELEMENTARY ACCOUNTING

C. A. Fryxell

In accordance with the request that this session be a discussion of practical problems of teaching elementary accounting, the author of this paper will try to be as practical as possible. Far from hoping to present anything entirely new, either as to problems or solutions, he will treat of a situation which merits consideration chiefly because it is old, and consequently of common occurrence. It is a problem with which most instructors are only too well acquainted.

The instructor of beginning accounting at most small colleges faces a dilemma. This dilemma is the necessity, and at the same time the difficulty, of teaching in one class two widely different types of students: those who are taking only the one course as part of their general education; and those who intend it as a groundwork for further study toward a major in accounting. In all conscience, the needs of both groups must be met as fully and as thoroughly as possible; and therein lies the problem, for obviously their requirements are not the same. One group needs an extensive course; the other, an intensive one. To the first group the course is relatively an end in itself; whereas to the other it is rather a means toward a more distant goal.

The student who is planning to continue with accounting as his field of work, needs above all else a solid foundation for the more advanced courses. Possibly if a group of accounting instructors were to name just two results as the most valuable to be desired from the beginning course, they would specify first, thoroughness, and second, accuracy. With students coming from our high schools often poorly prepared in the simple but fundamental processes of arithmetic, the instructor is at a loss as to how much time, if any, he can spare for a review of such essentials. Is it his function, after all, to spend valuable time teaching students that which they should already have learned in high school? Possibly you may say no; and yet who can hope to become a successful accountant who has not mastered simple arithmetic? Besides mathematical processes there are many phases of accounting technique which the student pursuing an accounting major must understand if he is to continue with advanced study of statement analysis, cost, systems, and general problem work.

On the other hand, perhaps the majority of students enrolled in first-year accounting classes have no intention of following the subject beyond that point. They may be taking general economics majors or they may be liberal-arts students. Their desire is for

a general course which will enable them to understand a simple balance sheet, read the financial pages of the morning paper, or talk with some show of intelligence about business matters in general. Their interest in working papers, columnar journals, and control accounts is casual at most; and possibly their knowledge of detailed accounting methods is not, after all, essential.

The problem, then, is clear; but what of the solution? Obviously, to give one course, and that a thorough one, to accounting students, and another course with a different approach and emphasis to the law or engineering student, the general-business or liberal-arts student, is the best solution. Just as obviously this is out of the question at the small college where only the one course can be offered. Two lines of procedure are open. The first is to provide a review and a more intensive study of certain phases of accounting mechanics during the first few weeks of the advanced course. This proves satisfactory where the advanced course is spread over two years, or where, if only one year is offered, the class meets four or five times a week. However, where more commonly only one year's work of three meetings a week is possible, extra time for the review of fundamentals can hardly be spared.

The other method is to give additional time during the first-year course to those students who contemplate a continuation of their accounting studies. At Augustana College I have generally followed the latter procedure. At this college, elementary accounting is a three-credit course, scheduled for two recitations and one laboratory period per week. During these regularly scheduled hours the general subject matter and minimum requirements of the course are covered. Then, in addition an extra hour each week or every other week is announced as a quiz or review period, and such members of the class as are interested are invited to attend. During this period opportunity is offered for questions and exercises. As much time as possible is given to journalizing as a means of testing knowledge of principles. Problems may be solved against a time limit; or possibly a student is called upon to criticize another's work.

Thus far during the fall semester the following subjects have been the ones discussed and drilled on: Fundamental processes of arithmetic, journalizing simple transactions, use of working papers, computation of interest, trade and cash discounts, accounting for notes and drafts, and adjusting entries. During the remainder of the year sessions will probably be devoted to such topics as the use of control accounts, columnar journals, partnership problems, and corporation entries.

At these special, or quiz sessions attendance must of necessity be voluntary, but it is gratifying and often surprising to see how many students will come: some undoubtedly because they want to better their immediate grades, but many also because they realize that every moment spent on perfecting and strengthening their foundations will stand them in good stead in advanced courses. Thus far, attendance has averaged from 50 to 60 percent of the regular enrollment in the beginning classes. I find that these are some of the results that have been obtained:

(1) Students have been stimulated to increased interest in accounting. Possibly the enrollment in the advanced classes will be boosted.

(2) Weak spots in student training have been revealed and, so far as possible, corrected.

(3) A degree of thoroughness has been attained which would otherwise have been impossible.

Needless to say, I have had great personal satisfaction from the reactions of students.

Whether you look at the procedure described above as being something as old as accounting instruction itself, or whether you consider it experimentation does not matter. The fact remains that I have always felt the need of greater thoroughness and accuracy among accounting students, and I am confident that such results as have been attained in this respect have fully repaid me for the effort expended.

TEACHING AND TESTING THE BOOKKEEPING PHASE OF ELEMENTARY ACCOUNTING

Leo A. Schmidt

My general topic is "putting across" the bookkeeping phase of the elementary accounting course. More specifically I am interested in the types of tests or examinations which can be given to bear directly on the students' acquisition of bookkeeping technique. Perhaps I am being unpleasantly honest when I say that this matter of bookkeeping is a phase of the elementary course which is often unduly slighted in our eagerness to get at what we consider material more worthy of a college course.

Bookkeeping training naturally falls into the first course. To teach it well enough so that it will be retained by the student until after graduation and in the meanwhile constitute a reliable back-ground for work in other accounting courses, is a task well worth careful consideration.

To a very slight extent perhaps we can take cognizance of bookkeeping courses our students may have had in high school. Personally I think that 99.44% is the proper discount rate to be applied to such preparation. Some colleges have instituted short "preaccounting" courses to take care of bookkeeping. Probably the commonest method is still to relegate the burden primarily to a laboratory section where more or less extensive sets can be worked out. If this work is coördinated with the text chapters and class discussion on the development of technique the combination has usually been considered quite satisfactory.

At Marquette University we use neither of these methods, but rely upon the regular classroom discussions and home-work assignments to teach the principles of bookkeeping as well as other phases of accounting. Our elementary course given in the sophomore year runs for four hours per week through the year. Every session is a combination of lecture and quiz. None of the class time is devoted to the supervised working of problems or sets.

The first three or four weeks of the course are devoted to straight accounting theory by the balance sheet approach, all work being done either directly on the balance sheet or in a T account ledger. This direct entry work is carried through the analysis of the types of transactions, closing entries for service and trading concerns, adjusting entries, trial balance, and profit and loss statements, without any mention of books of original entry or any form of journalizing.

At this point, having covered a big portion of the theory of accounts in direct entry form, the necessity for developing techniques to take care of the enormous volume of routine entries in actual business is presented to the student. He is told clearly that his work for the following period of several weeks involves no new theory, no new types of entries, and so he is much clearer in his own mind as to just what this portion of the work does embrace, that is, bookkeeping as such.

This division of the work follows closely the differentiation of accounting and bookkeeping on the basis of functional definitions. From this point of view accounting is the study of the underlying relationships found in business data, while bookkeeping is the study of the forms, devices, routines and procedures necessitated, not by fundamental relationships, but solely by the volume of business facts that must be recorded and by the relative frequencies of different types of transactions as they vary from business to business.

If we can thus pose the problem of bookkeeping properly, so that the student sees clearly what we are after, the battle is three-quarters won. It is my contention that the concentration of the subject of bookkeeping in a certain restricted portion of the elementary course makes it possible to pose the question properly, whereas spreading it out over the year's work through laboratory sessions or otherwise confuses questions of fundamental relationships with the more restricted problem of technique as affected by volume.

In the following this plan of concentrating our teaching of bookkeeping into a period of three weeks or so certain changes have to be

made in the type of practical work given the student.

The trend clearly noticeable in textbooks of the last ten years toward shorter bookkeeping sets, must be carried considerably further. It must be carried to a point where a complete bookkeeping set can be given as a one or two day assignment. One method already used to some extent in shortening set work, and which can be carried still further, consists of having the routine work in some of the journals already written up for the student by a supposed assistant, thus delicately flattering the student into the position of head bookkeeper.

Another method of cutting down the routine work is to put before the student a bookkeeping system as it would appear after a considerable portion of an accounting period's work has been done. The student takes charge of the books at that point and finishes the work for the period. This embraces the making of detailed entries in every book and in every column thereof but with a minimum of repetition. The posting required involves the detail from every column and the totals of columns for the whole period. The column totals produced in this manner are of such size and proportions that a much closer similarity to actual working conditions is attained than is usually possible in a short set involving all of the supposed transactions for a period.

The bookkeeping sets used should represent as great a variation of types as is possible from the simplest to those of a considerable degree of complexity. My own policy has been to require the students to rule all of their own books working from written descriptions or from suggested blackboard models. Whether the extra time thus consumed is well spent in actualizing to the student the essential flexibility of accounting systems may be debated.

These sets are assigned for outside preparation just as any shorter problems would be. They are brought to class by the student presumably completed and correct. Only a small portion of class time is spent in checking the numerical results as shown by trial balances, schedules, P. & L. statements and balance sheets. The chief classroom emphasis is given to a critical study of the relationships of the books of original entry to the ledgers, that is, to the *posting system.*

Usually it is desirable to sketch the books of original entry on the blackboard together with skeleton ledgers. The discussion inevitably turns to the advisability of changes in the system, the addition of columns or the splitting up or combining of the books in different combinations. In each case the question "how would you post the detail and total from the new arrangement?" points to the real essentials of the proposal.

Constantly, every student is held responsible for complete instructions for posting any form that is proposed. Our general rule as to the detailed accuracy required is summed up in the constantly repeated admonition, "Your instructions must be so airtight that they could not be misunderstood by even the dumbest bookkeeper for whom you might be designing this system."

I believe that the point of view implied in this statement, i.e., that the student is the potential systems accountant is the right one for putting bookkeeping across to him. Possibly this attitude overshoots the usual province of an elementary course, but the beauty of it is that it works. When a student has honestly considered such typical systems questions as, "What constitutes the proper bookkeeping system for this particular type of business?", "Just exactly when does it become advisable to add another column for a relatively frequent type of transaction?", "Under what circumstances should a given group of accounts be placed in a subsidiary ledger with a control account in the general ledger?", "Just what constitutes true economy in handling a certain type of transaction considering journal space, ledger space, writing effort, error probability, etc.?"—when he has tried to answer these questions not as rhetorical abstractions at examination time, but in application to a great many specific cases in the discussion of concrete problems, then he is not likely to be stumped by the difficulty of running routine transactions through any particular set of books.

To give point and certainty to this method

of teaching the bookkeeping phase of accounting it is necessary to back it up by examinations the threat and actuality of which really require the student to know what he is talking about. It is desirable to tell the students quite specifically what type of examination they may expect on this work, and no harm is done if their fraternity files prove such statements to be no idle threats.

At Marquette University a one-hour examination is regularly given about the middle of the first semester as a climax to the major bookkeeping offensive. It comprises in one form or another a set of books which is entirely new to the students. New combinations of the major books may appear, new columns previously unused, control accounts for new sets of data, anything and everything that can be invented is fair in this examination.

While it is quite clear that the examination should concern itself primarily with the posting scheme of a new set of books, since this is the very heart of the bookkeeping problem, the question still remains as to form of examinations which can adequately test the student on this all-important point. The "describe and discuss" type of question is easy to ask but obviously too vague to be really useful. The following outline represents some years of experimentation on this question of the specific form to be used. The five types described seem to the writer to about exhaust the possibilities. All five have merit, and much further experimentation will be necessary before any one form can be chosen as definitely superior to the rest, if indeed such a choice will ever be possible. A carefully prepared examination in any one of these forms can obviously be superior to a hastily prepared one in any other style. Possibly specific differences in classroom discussions leading up to the examination would make one form more effective than another; possibly the relative ability or maturity of the group to be examined would dictate the choice.

Briefly stated as the compass of this paper requires the types may be outlined as follows:

Type I: Books of original entry shown without any figures, ledgers merely named. Problem is to write complete instructions for posting, i.e., detail and total of every column discussed.
  a. Instructions to be written directly in the columns concerned.
  b. Instructions to be written on separate sheet, student making his own references to books.
  c. Instructions to be written in special form supplied with the examination, in order to gain objectiveness in grading.

Type II: Books of original entry shown without any figures, the ledgers shown but without figures. Problem is to enter in the books certain representative transactions, and to post these to ledgers.

Type III: Books of original entry shown without figures, ledgers shown in balance as of beginning of an accounting period. Problem is to enter certain transactions representing a whole period's business, to post books for whole period and get trial balance and supporting schedules.

Type IV: Books of original entry shown with figures representing totals of columns for part of an accounting period (first 25 days of a monthly accounting period for instance), ledgers also shown with figures giving effect to all postings which would normally have been made by that time (i.e., all detail postings). Problem is to enter certain representative transactions for remainder of period, complete all posting and get trial balance and supporting schedules.

Type V: Books of original entry and ledgers shown, with figures in both representing actual bookkeeping situation with all work for the period completed except for the detail postings of the last few days and total postings as of end of period. Problem is to finish posting and get trial balance and supporting schedules.

In any one of the types of tests as outlined it is possible to use any bookkeeping setup from a simple set comprising a special column cash journal with general, customers' and creditors' ledger to a formidable set with numerous journals all carrying special columns and involving as many control accounts and subsidiary ledgers as the instructor may wish.

The difficulty of the examination can be greatly increased in any case by omitting the ledger folio columns from the various journals thus depriving the student of an automatic clue as to whether details are to be posted or not.

In types II, III & IV which call for actual journalizing by the student, the difficulty may be

adjusted by using transactions varying from straight routine happenings to any type of complicated happenings involving compound entries, contra entries in several books, adjustments of previous errors, etc.

An incidental advantage of these examinations is the fact that they are highly objective, and in no case reflect such imponderables as the students' rhetorical ability. In most cases they are easy to grade, indeed, the one type (I.c.) is so organized that you may turn the grading over to your stenographer as well as not. This is the sort of objectiveness one finds on modern civil-service examinations, and while it may be carrying objectivity to unnecessary extremes, its possibilities in view of our large classes and small faculty personnel should not be entirely neglected.

In preparing this paper I have been haunted by the fear that I would give the impression of a grievous over-emphasis on the bookkeeping phase. Quite the contrary is true. I believe it is safe to say that the total student and faculty time applied to bookkeeping as such under this method is probably less than is usually given the subject. While the method does take a solid section of about three weeks out of the semester for this work, it does save all the time and energy usually devoted to laboratory periods as well as the discussion time usually devoted to chapters on development of technique as found in most textbooks.

The thesis of this paper may be summed up in a short statement: The effectiveness of our teaching of the necessary bookkeeping phase of elementary accounting can be increased by (1) concentrating the attention given to it in a short period, and (2) by reorganizing the type of material used to test students on this work.

In conclusion it must be acknowledged that much of the argument presented here may not be particularly unique nor original. Much the same type of work has probably been done before in other institutions. Insofar as this is the case it is evidence of the very real need of exchange of ideas in the pedagogy of our subject, such as can be brought about through the A.A.U.I.A. and the ACCOUNTING REVIEW.

METHODS OF TEACHING A SURVEY COURSE IN ACCOUNTING

HARRY H. WADE

Survey courses are limited, apparently, to one semester or less and under such conditions it becomes our rather difficult and painful duty to devise teaching methods which will, in the brief time allotted, convey a reasonably intelligent concept of basic principles and procedures. Results are unsatisfactory if the survey course is merely a duplication of the first semester of a standard one-year course. The usual and better procedure, I believe, is to abridge the year course by a careful process of elimination and condensation. I suggest, timidly, the elimination of any extended discussion of notes, bills of exchange, note registers, location of errors, business papers, merchandising activities, and various unusual and complex transactions. The usual treatment of partnerships, corporations, columnar journals, voucher system, and manufacturing accounts may be condensed without sacrificing basic concepts. The number of problems assigned to illustrate any one principle must be reduced, unfortunately, and repetition of procedure in problems should be minimized. Laboratory material, with specially ruled and printed forms for the solution of problems, is very essential.

If we abridge the year text in this fashion, teaching methods in the survey course will approximate those employed in the year course. At least the sequence of ideas, as we present them to the students, will remain unchanged. At the State University of Iowa, however, the sequence in our survey course does not correspond to the sequence in our one-year course. I suppose the method which we use in our survey course may be described as the "equation approach" or possibly as the "statement approach" and it is, by no means, original with us. Briefly, our method is as follows: Simplified operations of a real

estate broker are used to illustrate the following equations:

(1) Assets = Liabilities + Net Worth
(2) Sales − Cost of Goods Sold − Expenses = Profit
(3) Net Worth (start of period) + Profit + Additional Investments − Withdrawals = Net Worth (end of period)

Each equation is expanded later into the corresponding formal statement and for the first three weeks, approximately, the student is engaged in preparing successively difficult statements. In this process the student becomes familiar with terminology, classification of assets, computation of the retailer's cost of goods sold, classification of expenses, etc. In this process, also, are emphasized the relations between statements and within statements, including percentage relations, ratios, turnovers, and even comparative balance sheets. All of this is done before the account or the principle of debit and credit are introduced. At one time, I would have been shocked and very scornful at such a procedure, but now I am inclined to approve. After all, the principle of debit and credit is not contained in the statements. In fact, I do not think there is anything in the statements which cannot be explained in everyday language or with the use of simple arithmetic.

After the student is familiar with statements, we introduce the account, analysis of transactions, into debits and credits, and the trial balance. We emphasize, in this process, that the purpose of recording transactions is to supply information for the preparation of statements and that the student is to keep this in mind constantly. After the preparation of the trial balance the student is on familiar ground. He again has a list of information from which statements are to be prepared. Problems, at this stage, do not require statements, however.

We next discuss adjustments, not as they are recorded in the journals or the accounts, but as they are entered in the working paper. After this, the working paper is completed, statements are prepared if time permits, and adjustments are entered in the accounts to effect their agreement with the statements. In general, the student is encouraged to believe that the statements are an end and that other procedures are a means to that end.

The closing process is the student's next problem. Instead of starting with a very simple set of accounts and later expanding the process from time to time as new accounts are introduced, we avoid this repetition by using an extended list of accounts the first time this procedure is explained. The student is instructed merely to make three entries as follows:

1. Debit each account whose balance appears in the credit side of the profit-and-loss column of the working paper. Credit the profit-and-loss account with their total. This entry may be copied, of course, directly from the credit side of the profit-and-loss column.

2. Credit each account whose balance appears in the debit side of the profit-and-loss column and debit the profit-and-loss account with their total. This entry may be copied from the debit side of the profit-and-loss column.

3. Debit the profit-and-loss account and credit the surplus account with the amount of profit. Variations for loss are recognized, of course, and withdrawals are closed in a fourth entry.

While we sacrifice pedagogical approval, perhaps, we do save valuable time and I believe the student gains a correct idea of the purpose of this process.

From this point on, the following material is introduced in the order named: simple journals, columnar journals, a review problem, manufacturing statements and accounts, voucher register, controlling accounts and subsidiary ledgers, problems in valuation such as depreciation, depletion, appraisals, amortization, and funds and reserves.

The significant feature of this approach is that the student examines each new procedure from the viewpoint of statements rather than from that of accounts. Com-

merce students should be well-trained in accounting technique and it is quite logical to build their knowledge of accounting on a thorough understanding of the accounts. However, the purpose of a survey course differs entirely from that of a one-year course and it is not illogical, at least, that teaching methods in the two courses should differ. I believe that a survey course should emphasize statements and if, by reason of a time limit, something must be slighted in the last few weeks I would prefer that material to be other than statement preparation and analysis.

EMPHASIS IN COST ACCOUNTING

J. C. Gibson

Regardless of the ultimate position which the National Industrial Recovery Act may occupy on the political horizon, it has already succeeded in making the business world increasingly conscious of cost accounting. There is no reason to expect that the ground gained will ever be lost and every reason to believe that through trade associations and similar organizations cost accounting will gain additional importance in our national business life. Therefore it is advisable to survey the cost courses given in the universities and colleges of the country to see whether they are designed to give the student the proper training in cost accounting.

There has been a noticeable tendency in the past to consider cost accounting as an entirely new and unrelated subject, even slightly mysterious in nature. Probably it is safe to say that when the instructor approaches the cost course with such an attitude, the subject continues to remain a mystery to the student. In reality the study of cost accounting is simply an expansion of the study of one of the functional groups presented in financial accounting, the manufacturing function. In cost accounting the student learns how the information which he used in financial accounting is obtained for a manufacturing concern.

It is my contention that the methods developed in the teaching of financial accounting should be followed in the teaching of cost accounting. From years of experience, the teaching profession has approximated a general agreement as to the objectives of financial accounting courses. It is considered essential to teach fundamental accounting theory, to illustrate modern methods of recording and presenting data, and more recently perhaps to ground the student in principles of statement analysis and interpretation. This latter training is necessary if accounting is to occupy its proper place in the formulation of managerial policies.

Emphasis is not placed on the study of business forms or on office procedure and routine. These are merely incidental to the accomplishment of the chief objectives and in well planned courses are used as teaching aids in the visualization of the business transactions involved. The emphasis is placed on the analysis of the transaction into its elements, on the accounts affected, and on the interpretation of the results and relationships as set forth by the accounts.

Applying the same principles to cost accounting, cost courses need not be burdened with unnecessary detail as is frequently the case. Cost accounting is inherently detailed in nature and most of the available cost texts devote a large proportion of their contents to the discussion and presentation of detail. Unless care is exercised, students will suffer from the deadening effects of detail even as cost clerks in actual practice succumb to cost systems unsympathetically installed where elaborate records are kept, thereby producing unused information which can result only in the stimulation of sales of filing equipment. Of course it is necessary to study receiving reports, material requisitions, stores' ledgers, daily time tickets, etc., but this sort of work should be kept at a minimum. The ruling or arrangement of a particular form as used by some company is not important. The classification of the information it contains and the record to be made in the accounts *is* important.

The question is one of emphasis and perspective. The important phase of our teaching in cost accounting is not the detail which

will vary from company to company, but fundamental cost theory, modern methods of recording and presenting cost data, and in view of recent developments, a clarification of the controversial features which tend to confuse untrained legislative and administrative officials.

There is certainly some distinction between cost finding and cost accounting. There must be some characteristic which differentiates the cost clerk or cost engineer from the cost accountant. That characteristic is accounting perspective which enables the accountant to see the final disposition of data contained in the detailed records; the ability to visualize account relationships and to analyze and interpret the significance of final results as revealed by the accounts.

The teacher of cost accounting should, therefore, project the cost routine into the books of account so that the student may see the accounting aspects of costs. More time and effort should be spent on the accounting end of the subject. It does not seem that a cost course should present but one cost accounting system but rather the several different systems in general use, each one possessing important features. And yet most cost texts present only one system, although one widely used text does present two, the controlling account type and the estimate type. The student in practice will be confronted with situations where it is distinctly advantageous to have a wider knowledge of possible variations in system account design.

There are some cost systems in use which destroy the very accounts which in financial accounting we have endeavored to teach as not only desirable but essential. I refer to the system whereby the factor accounts are closed in routine fashion so that the ledger instead of containing the necessary data for statement preparation or for tax returns shows only the inventories of raw material, work in process, finished goods, and a lump-sum total for cost of sales. To prepare statements or file tax returns under this system it is necessary to consult memoranda or supporting schedules, as the information supplied by the accounts is inadequate without laborious analysis and unravelling.

Likewise in the accounting for factory burden the account set up is worthy of careful consideration. The accounts should reveal the individual factory expenses for the period based upon correct accrual accounting in sufficient detail to insure equitable distribution to operating departments. After this has been accomplished the problem of recording burden applied to production presents itself.

In my judgment it is much better to establish separate burden distribution accounts to which is credited the burden applied to production, than to use for this purpose the same accounts to which the burden for the period has been charged. This simple device permits both the total amount of burden for the period and the amount actually distributed to production to appear in the trial balance and eliminates the necessity for digging out these significant facts as is necessary where a single account is used. This is just another illustration of what I mean by the desirability of teaching accounting along with costs. The underlying cost routine in every factory furnishes practically the same sort of information as to material quantities, labor hours and burden rates. The account set up may well vary in order to portray adequately and efficiently the operating results.

As a constructive suggestion it is stated that an ideal cost system is one that interferes the least with the financial records and yet furnishes adequate control over factory operations and supplies all essential information. This is best accomplished by the use of three separate sets of interrelated records which parallel each other throughout; the financial records, the cost records, and the budget records. All of these should be maintained on a double-entry basis. The financial records should contain complete operating-statement and balance-sheet data based on sound principles of accrual accounting as taught in our basic courses. The cost records should control factory operations and furnish production and inventory data. The budget records should serve primarily as a check

of estimated with actual results. The burden figures in particular reveal price fluctuation when compared with the financial records and adjusted for the efficiency factor as revealed by the cost records. The estimates may be set up as indicated by the following journal entry:

Dr. Estimated Manufacturing Cost
  Cr. Estimated Raw Material
    Estimated Productive Labor
    Estimated Burden (Detail)

At the end of the month, the financial records will furnish information as to the actual amounts for the period. These will be entered in the budget ledger opposite the estimated amounts and the variations revealed. In case it is desired, the above procedure can be expanded to include distribution costs or net operating results or may be limited to factory burden only. The set-up is flexible and can be adapted to requirements.

To summarize, in the presentation of cost accounting, let us profit by our experience in the teaching of financial accounting so that we gain the proper perspective, relate cost accounting to our previous work, teach more than one cost system and impress upon the student the accounting aspects of the subject. In the study of cost accounting, place the emphasis on the second word of the title and make it primarily a study of accounting for cost purposes.

TEACHING COST ACCOUNTING

L. O. Foster

The late Stuart Sherman, analyzing the virtues of an ideal teacher, stated as a primary requisite, this attitude: "The ideal teacher conceives of his own subject as central, whatever it is, and all else as subsidiary. He builds a universe around his own subject whether his subject is bookkeeping or botany." And, in order to include all teachers and all subjects, he adds, "This may be an illusion; but it is a vital illusion." Dr. Sherman, a professor of English, probably considered his reference to bookkeeping one of those extreme illustrations so well adapted to conveying a speaker's idea with startling force. However, let us for the moment, take him at his word and build our universe around the subject of Cost Accounting. Let us inspect it with a view to determine whether it offers the spark so necessary for becoming a living reality to the university undergraduate. Then let us question how it may be taught in order that the principles learned may serve to illuminate the complexities of life about him.

It is apparent that the instructor may have either of two points of view in teaching accounting. The subject may be considered primarily as a skill, a technique, or a method of recording and summarizing the facts of business transactions. With such an aim, emphasis will be placed upon the accounting processes and much time will be spent on accounting procedure. On the other hand, accounting may very well serve the useful purpose of providing a method for teaching business processes. Emphasis, under such a plan, will be upon the business implications back of the original data and upon the uses of accounting to the enterprise as a medium of social production as well as a means of individual profit making. This emphasis need not be at the sacrifice of a knowledge of accounts or their keeping. On the other hand, it is often possible that drills take the place of understanding while a complete knowledge of the business or physical processes often disperses the mysteries of the journal entry.

Cost Accounting is a very specialized, detailed technique and is concerned with bringing an intelligent order out of a mass of details. But, it may be more than that for the college student, for it is in the field of costs that accounting touches so closely that division of economics, production, most easily understood by him. The process of creating form utilities may be presented here with a clarity difficult or impossible to attain for the less tangible time and place utilities. Raw material costs and the costs of converting them into the finished product have an unavoidable simplicity. However, it seems to me that the teacher of cost accounting may miss the vital opportunity presented at this point for providing the connecting link

between cost of production for the individual and cost of production in a social sense. For example, the student should be led to comprehend that depreciation is an individual cost largely because the state of the arts for society depends upon capital, as an initial task, earning an amount sufficient to replace itself.

Production is but one of our social problems which may be taught through cost accounting. The pricing process presents one of the most difficult and complicated problems in the whole realm of economics. Yet, in our cost accounting textbooks, it is presented as woefully simple—a formula for adding a desired gross profit spread to the cost of production to determine selling price. That this is inadequate is putting it mildly. The student should be cautioned that the statement so often found that costs determine selling price can be just as appropriately and just as correctly turned around—that selling price determines costs. Rather, he should be taught that formulas merely set up reservation prices, that his product is only a part of the general supply which, as a total, must fit in the consumers' demand schedules. He should leave the course firmly convinced that cost accounting for a single firm simply determines whether that producer can sell at a profit under existing market conditions, that is, how close he is to the no-profit margin. The pricing problem and cost accounting cannot be divorced; they are inseparably bound together.

The distinction between industries of increasing cost and industries of decreasing cost is a vital one for society. This receives much attention in treatises on economics. However, it is the cost accounting teacher who has the best opportunity to point out the social implications of fixed and variable costs. He deals with them directly and in detail and may easily direct the student to consider them in terms of dollars and cents as a problem in business administration and from that lead him to a comprehension of their social consequences.

Let us consider just one more illustration. Not long ago a cost engineer, delivering a lecture before a group of cost accounting students, listed, as his major grievance against cost accountants, their practice of having production expense follow the product to the date of sale. He outlined a plan of expense allocation to fiscal periods rather than to the product. Although he did not call it that, he advocated dumping, a practice generally considered anti-social. The discussion after the speech made evident the fact that none of those students had thought of cost accounting as having any social implications.

All this does not assume just a single cost accounting course. There must be an elementary course with emphasis on the processes related to cost accounting and an advanced course on technique for those special students interested in the more involved problems cost accounting presents. The first course serves as an introduction for the professional student and a broadening course for the general student. Neither does it assume that the student is not taught such things as, for example, price determination and capital replacement funds in other courses. But it does assume that repetition and variety in forms of presentation are the most fundamental of pedagogical devices. Because of the underlying importance of manufacturing processes in a machine age, cost accounting serves as an excellent medium for teaching the essence of production. Instead of generalities and abstractions it presents specific situations and actualities.

The accountant has, for a long time, thought of himself as being surrounded by such problems as those of law, industrial management, statistics, corporation finance and investments, but he has been loathe to consider his field as having a very close connection with economics as a body of thought. However, if the accounting teacher will convince himself that these business administration and social problems are but another constellation in his universe, he will make his subject an indispensable adjunct to the university curriculum. He has an opportunity to help the next generation of cost accountants reach the heights their profession promises.

If we are to convince ourselves of the

worth of teaching such a field as cost accounting, if we are to regard it as "the center of our universe," it seems to me essential that we view it not only as a means of understanding and acquiring an involved technique, but as well a means of interpreting broad and vital economic principles. If a study of cost accounting throws new light upon economic values, then, we may believe, the student has acquired a deeper insight into the social structure—has been given a useful key to other values.

ON THE TEACHING OF AUDITING

Henry T. Chamberlain

The statement that a teacher is satisfied with the results obtained in his course should, I am sure, be regarded as news, comparable, perhaps, to the statement that a man bites a dog. What I have to say, therefore, is not news, for I am thoroughly dissatisfied with the results obtained in the courses in auditing at Loyola University. This should not come as a shock to teachers of accounting, for I think we will all agree that the course in auditing is the most unsatisfactory course in the accounting curriculum from the teacher's viewpoint as well as from the student's.

Now I do not hold that a student who completes a course in auditing should be able to take his place on the staff of a public accountant as a senior accountant. I do not even expect him to be qualified to do the work of an experienced junior. But it does seem to me that a student who completes a course in auditing should be able to count on his training to lead him through the bewildering maze of his first job in a public accountant's office. We all recognize that there is a wide gap between the classroom and the office, but I believe that much can be done to shorten it.

What I have to say on this subject is not intended as a criticism of auditing textbooks. A textbook has limits, and within those limits the authors of our standard books have done an excellent job of presenting the fundamental principles of auditing and the methods of preparing audit working papers and reports. However, a need exists for something to supplement the textbook if we are to give the student a real grasp of the subject. To me, the problem is one for the teacher and not for the author of the textbook.

Briefly, the teaching difficulties presented in an auditing course are:

(1) Our students, for the most part, have had no business experience whatever. They have never come closer to a set of books than their practice sets in their course in elementary accounting.

(2) Our problem material is inadequate. While short problems and questions are necessary for the purpose of testing the students' knowledge of fundamental principles, it is essential, if the course is to be most effective, that the student be given a fling at a real audit, with all the detail which he would be required to wade through in actual practice. To illustrate—I am sure that most of the students in our auditing courses would know how to reconcile a bank account if they were given a problem which stated the balance of cash as shown by the bank statement, the balance as shown by the check book, and a list of outstanding checks. But I wonder how many would be able to reconcile the same bank account if they were handed the bank statements, several hundred canceled checks, and the cash records. I am certain that most of my students would have quite a difficult time, not because they lack a knowledge of the principles of auditing, but because they have no idea of how to handle the large volume of material that one meets in actual practice. They would be submerged in details, and would be unable to apply the principles they have learned.

These difficulties have been recognized for some time and attempts have been made to remedy them. It has been suggested, for example, that the records of defunct businesses be procured to serve as laboratory material for the auditing class. I need not point out that it is not easy to obtain the right type of material from this source.

The accounting department at Loyola University has given a good deal of thought to ways and means of overcoming these difficulties and much experimenting has been done, but still the results have not come up to expectations. Just at present, we are in process of working out an idea which I believe will go a long way toward solving the problem, and I hope I will be pardoned if I go into some detail with regard to our plan.

The members of the department have undertaken the task of preparing four sets of transactions with about two thousand transactions in each set. When finished, one set of transactions will be for a small trading concern; another set will be for a small manufacturing company with a cost system tied into the general books; the third set will be for the business of a commission merchant; and the fourth set will be the accounts of a general contractor. In each case the transactions are to run over a period of seven months.

Our plan is to hire advanced students as bookkeepers to write up these transactions in books and to prepare all supporting documents such as checks, sales invoices, purchase invoices, receiving and shipping records, inventory sheets, bank statements, etc. The department hopes to complete its work some time during this coming summer and we will then have four complete sets of records available for audit by the members of the auditing class. The audits in each case will be for a six-months period—that is, the date of the examination will be one month after the date of the balance sheet. The students will be required to prepare all necessary working papers and the report to the client.

The introduction of this laboratory plan will require a complete change in the set-up of our auditing course. Heretofore, the course has been offered on a two-semester basis, two hours of credit being given each semester. Under the new plan the course will run over two semesters, four hours' credit being given in the first semester and two hours' in the second semester for four hours of laboratory work. In short, what is now being given in two semesters in two hours each week will be covered in the first semester in four hours each week. The work of the first semester will lay the foundation in the fundamental principles of auditing and will be based on one of the standard auditing textbooks, supplemented with problems and short cases. The second semester will consist of laboratory work on the sets.

The auditing laboratory will be under the supervision of a laboratory director who will act in the capacity of supervising accountant. The students who register for this course will be divided into teams of two or three, and each team will be assigned to one of the audits by the director. It is our opinion that the laboratory period, to be most effective, should have a duration of not less than three and one-half hours.

It will be the duty of the laboratory director to consult with the students regarding the preparation of the audit program, the form and content of the working papers and the report, to outline the work to be performed by each member of the team on the audit, and, in general, to give whatever aid he thinks necessary. In the opinion of the department, each student in the course should work on at least three of the four audits, the assignments to be different on each audit, if possible.

In the laboratory work an attempt will be made to duplicate the conditions of actual practice. The student will have available all records of the business including all supporting papers; and he will be required to prepare his solution as he would were he a member of the staff of a public accountant.

When a student registers for a course in auditing he should be accepted as a candidate for a position on the staff of some public accountant. While it is true that no amount of classroom or laboratory work will take the place of actual experience on a public accountant's staff, I do believe the plan we are about to undertake will decrease the gap that exists between the two. In other words, it is our hope that our students, when they go into the public accountant's office, will not be the greenest of juniors.

While the plan will, undoubtedly, require

many refinements and adjustments in actual operation, we believe it is the solution to our difficulties, and are very anxious to inaugurate the experiment.

AUDITING TEACHING METHODS

E. C. Davies

In any consideration or discussion of the methods of teaching in Auditing it would seem that the question of paramount importance, or at least the one causing the most difficulty, is what might be called one of realism or practicability and the developing in the student of the feeling that the course is not just a theoretical course but that it is tangible and practical and has a direct relationship to actual business procedure.

There is no particular difficulty in connection with text material covering the theory of auditing. There is an overabundance of printed material explaining what to do in the course of any type of audit engagement, although much of this material consists principally of statements as to what the auditor should do. There is also plenty of material for collateral reading, textbooks, reference books, governmental reports, association reports, et cetera. In fact, the chief difficulty in this respect is to select and organize this material so that it can be used in the short space of a two- or three-hour one-semester course along with the other material that all of us think necessary in our own particular fields.

The chief difficulty is in giving the students an understanding and appreciation of the practical problems of audit procedure and the developing of a sense of realism in the course and in the work. Most students, particularly day-students, have no more knowledge or understanding of actual accounting records or the way they are kept than they have gained from the practice material in the first year's work, and naturally this has been held up before them as *the* method. Their acquaintanceship with books of account is limited to the practice set and probably many of them are laboring under the delusion that in actual practice the accounting records will look like the practice set, that the same journal will be kept, that the same classification of accounts will be used, and that the records will be handled in exactly the same manner. This same situation holds true with the evening students, but to a much lesser degree as many of these students are employed or have been employed in business offices; and even though they are not actually working on the books of account they have associated with those who do work on them, have heard some of the problems and difficulties, and are at least acquainted with the books and have some knowledge of how they are handled. The student who has never been in business or whose business experience has not taken him into the office and whose acquaintanceship with accounting records is limited will, of course, have some difficulty in appreciating the problems of auditing or of really understanding what is being attempted in the course.

The ideal and most satisfactory method of handling the situation would be to have actual accounting records and to have a wide enough selection to illustrate the variations in form and procedure that would be encountered in actual business and a sufficient number of sets of books so that students could work on these records individually under the supervision of the instructor, developing a method of procedure and going through all the steps of an actual audit from the working trial balance to the audit report, with the instructor acting in the capacity of a principal assigning the work. At Northwestern University we have given serious consideration to the possibility of securing access to actual books of account such as student organizations or as is done in one School of Commerce, I believe, accumulating a library or collection of the accounting records of defunct or bankrupt organizations. To date, however, we have not succeeded in working out either of these plans. The student organizations have been reluctant to permit other students to have access to their records and with the number of students involved the collection of ac-

counting records has not been practical chiefly because of the lack of physical facilities both as to working space and storage space.

The only alternative has been to omit the work on actual books of account and start the student in audit procedure with the working papers. With each lecture we give the student reproductions of the working papers of a balance sheet audit of a commercial concern, each assignment covering the accounts discussed in that lecture. We require him to set up his working trial balance on standard fourteen column analysis paper from the data given in the audit problem, to analyze the work sheets, and prepare the necessary adjusting journal entries, to apply them on his trial balance, to prepare the necessary financial statements, and finally from the information available in this material to write an audit report such as might be submitted in an audit of this kind. Every effort is made by the instructor in the class discussion, special readings, et cetera, to have the student see the relationship between the working papers and the actual work and to bridge the gap between the working papers and the books of account. In this connection I have found it worth while to make up a number of sets of working papers using regular analysis paper and to pass these around the class so that the students will have a better understanding of the originals from which the reproductions were made. As many of the students have never seen an audit report and have no idea of the actual appearance, it has also been found desirable to accumulate a file of audit reports and to have the students examine these reports before beginning to write the report to be submitted, so that they will have a clearer conception of the content and appearance of the completed report than they can get from an examination of the reports illustrated in any of the numerous texts on auditing.

With the day students, it has also been found of value to offer a two-hour laboratory session once a week where the student is given more and special attention in the handling of problems such as might be encountered in actual practice, as, for example, bank reconciliations. It might be of interest to note that although the laboratory work is optional, the majority of the students whose programs permit avail themselves of the privilege and I do not believe that this laboratory session is known as a "snap."

It is also difficult to secure realism in the problems for outside work or home work, as practical audit problems suitable for a class in auditing are hard to find and the amount of explanation and reproduction of forms necessary to outline such problems to students not acquainted with varied accounting records is such as to practically preclude their use in the ordinary semester course. The only other alternative seems to be to make use of problems that will furnish training in the assembly and control of complicated data usually encountered by the auditor in actual practice. In the course at Northwestern University the problems for home work are selected not with the idea of introducing new accounting principles but with the object of attempting to develop in the student the ability to read and understand the facts given, to analyze the information, to plan a method of solution and to handle the data logically and consistently. Many of these problems emphasize the work sheet or the work-sheet method of approaching the solution. Every effort is made to develop an analytical approach with the hope that the student will carry this attitude into his later work.

The teaching of auditing would no doubt be more interesting to the class and to the instructor, and probably more successful, if we could take students out into actual audit practice, as we could then develop realism to the last degree. If there were any way in which we could give students the beginnings of the course or a foundation in auditing theory, and then have them go into actual practice for a few weeks, later returning for additional class work, the remainder of the work would certainly mean much more to them. I understand that this is being done in certain schools that are on the quarter system, the winter quarter being used for this purpose. Unfortunately, those of us that

are on the semester basis are denied this opportunity as the two-semester school year is hardly adaptable to any such arrangement; and I am afraid it would be somewhat difficult to try and place our students during the summer vacations. Lacking these opportunities, however, it would seem that if we make every effort to develop realism and if above all things we develop in the students an analytical approach, they at least will not be totally lost when they get into actual practice but will be able to work out a method of procedure and will themselves be able to bridge the gap between the "what-to-do" of auditing theory and the "how-to-do-it" of auditing practice.

THE COURSE IN C.P.A. PROBLEMS

Jacob B. Taylor

A course in C.P.A. problems is universally accorded a place in the curriculum in the senior year and represents the end of the work in accounting for the accounting major. Here is an attempt to bring in materials from the outside with which to test the mettle of the prospective accounting practitioner. Here is a departure from the consistent use of materials created by university teachers in accounting to extend and develop the teaching of accounting principles. Perhaps to the alert student, there is carried a warning of harder days to come, of more complex problems to solve in the work which lies ahead. If no greater benefit were to be obtained by the student than the premonition that there was still much that he did not know about accounting, then the C.P.A. problems course would have more than justified itself. If properly taught, this course presents the best means yet discovered of deflating an exaggerated case of ego.

In searching for the specific purpose of a course in C.P.A. problems, it can be stated that it should provide a thoroughgoing review of accounting principles and practices. This means that by the use of C.P.A. problems an attempt should be made to cover the field of accounting in review. Certainly before the student should be enrolled for the C.P.A. problems course, he should have completed the courses which develop the theory and principles of advanced accounting including cost accounting, analysis of financial statements, and income tax. Thus, if this is the case, the student is given a chance to solidify his knowledge of the fundamental principles and practices while learning to appreciate the possibilities of new applications of principles and new procedures.

To insure the maximum in results for the effort expended by the student, the selection of the problem material must be judicious. It goes without saying that not all C.P.A. problems and questions are good. In fact, those who have made any serious study of the questions which have been given to candidates for C.P.A. examinations have soon learned that much of the material could be vastly improved. The defects of the material are many. Some problems are written in poor English and cannot be given to the students until some attempt is made to at least overcome the grammatical deficiencies. Other problems, while not ungrammatical, are stated in an ambiguous manner and the only thing difficult in these problems is in finding out what their authors meant to say or to ask. Some of the latter questions require very little preparation in accounting but necessitate the possession of second sight on the part of the student in order that a satisfactory solution may be prepared. Still other problems contain an unnecessary amount of detail and require solutions which are extremely lengthy and which give the student nothing more than a drill in handling great masses of figures, the accounting principles developed being elementary in their nature.

That there are good problems goes without saying. There have been many throughout the years. It is also true, however, that they do not exist in as great abundance as may be desired and the problem of selection therefore is made more difficult. Nevertheless, every effort should be made to secure suitable problems.

The outline of the course should be such

as to produce the systematic review spoken of above. The particular manner in which the course is developed is not as important as is the need for coördinating the material. There should be some central plan of developing the work and the problems selected should be in furtherance of this basic idea. The practice of selecting problems hit or miss, and having the students work the problems mainly for the exercise involved therein, seems to me to be an ineffective method of teaching. The C.P.A. problems course could not long be justified if this were the basis of its operation.

If the class meets once a week for a semester or twice a week for a quarter, the amount of problems needed will be considerable. As a minimum, the student should prepare a solution to an assigned problem for each meeting of the class. In addition, other problems should be available for use as class problems to test the student's progress in the course. The selection of these problems should be in advance of the opening of the quarter or semester and should follow some acceptable plan of grouping and arrangement in order to afford a coördinated basis of review of the work of previous courses.

Much emphasis has been placed on the question of review and none has been placed on the point of making this course a coaching course for the C.P.A. examination. It is my opinion that there is no place in the undergraduate curriculum for such a coaching course. It presupposes that every student is aiming for the C.P.A. examination and a career in public accounting. This overlooks entirely other fields of service for those possessing adequate training in accounting. As a matter of fact the great majority of the graduates of our accounting departments will not go into public accounting work but will enter work in industrial accounting or other accounting positions. At least that has been our experience in Ohio, where the great industrial plants and centers attract our students immediately upon graduation and where as a rule they remain.

To make the C.P.A. problems course merely a coaching course for the C.P.A. examination would rob it of its usefulness for the great mass of accounting majors who regularly enroll for the course. To exclude all of those who were not going into public accounting from the course would deprive them of the possibility of making a systematic, comprehensive review on a basis which because of the type of material used would test their knowledge, courage, and ingenuity to the limit.

It should be said in passing that there has been quite a demand for a C.P.A. coaching course to be given at the University for graduates who have gone into public accounting to secure the proper amount of practical experience and who are now desirous of sitting for the C.P.A. examination. These men declare that in the years since graduation much of the theory has escaped them and it is imperative that they refresh their minds before taking the examination. Perhaps some obligation to these men should be recognized by the University and perhaps some provision for a coaching course should be made. It could probably be given to a limited enrollment in the autumn quarter when public accounting was at a low ebb or during the summer quarter. However this course, if justified at all, should be given in addition to, not in lieu of, the undergraduate course in C.P.A. problems. And in no case should the undergraduates and the experienced graduates be mixed in the same course; their needs are too different and the instruction required for the two groups are too dissimilar.

Regardless of whether the course is given as a systematic review or as a coaching course, the problems and questions selected should not all be from those given by one state board or from any other one source. If this is done, the selection of problems and questions is necessarily very limited. Some state boards have a preference for certain types of problems and use these types with more or less regularity. In the final analysis, the problem or question itself is not the important thing. Its value lies only in that it becomes the means of bringing to the student a new application of already acquired accounting principles or theory. There can be no doubt but that the best material for

the C.P.A. problems course is that which is judiciously selected from every available source.

There should be a liberal use of theory questions in this course so that the student may have an opportunity at this late point in his undergraduate accounting career to express his thoughts on theoretical matters. So much of his time may have been taken up with the application of principles in the solution of problems that he may have lost some of his ability to clearly express himself on purely theoretical questions.

Strange as it may seem, one of the greatest weaknesses of undergraduate students in their senior year in accounting is their inability, on the whole, to prepare journal entries. Despite the fact that their earliest introduction to accounting was through the journal entry, as they proceed from course to course, they seem to lose some of the art of making entries. Especially is this evidenced when they reach the level of the C.P.A. problems course. Here, when he is required to prepare entries to give effect to complicated adjustments or corrections, the average student is inclined to stumble around in his endeavor to meet the requirement. Some of the resulting entries are weird, to say the least. It seems imperative that problems be assigned in the C.P.A. problems course which call for the making of journal entries as one of the requirements. Since this is, at least partly, in the nature of a review course, full opportunity should be given to overcome so fundamental a weakness as this.

The chief defect of the entries as prepared by the average student is that he is careless in his selection of account titles and ofttimes uses titles which do not even appear in the trial balance for accounts which do appear therein. Again, the student may, in attempting to correct some situation, select accounts which are in no way affected and fail to correct the accounts which should be adjusted. I admit that this is a dismal commentary on the fundamental knowledge of our average senior student. But the sad fact remains that it is true. It may be the result of a liberal use of problems in preceding courses where statements were called for in the main and little practice was given in making journal entries. Then, again, it may evidence the lack of a thorough comprehension on the part of the student of fundamental principles, and the errors made may result from uncertainty and indecision. In any event, such a weakness should be overcome and the development of the C.P.A. problems course should be of such a nature as to bolster up and strengthen the work of previous courses.

Here, in this last course in accounting which the student takes, is an opportunity to sum up all that has gone before. Here is presented the responsibility for straightening out all the tangled lines of fundamental theory and principle. Beyond all this, however, is the opportunity to extend the knowledge of principle and to add many new procedures. This is my conception of the purpose of the C.P.A. problems course: an advanced study of accounting principles and procedures, with ample opportunity afforded for the review of theory and the restatement of principles.

THE C.P.A.-REVIEW COURSE

S. G. Winter

A C.P.A.-review course seems to be regarded generally as designed to meet certain needs of a relatively small group of students. It usually appeals to those who are interested primarily in professional accounting work and who hope to receive the certificate of certified public accountant—that magic parchment which, in the eyes of the layman, approximates a guaranteed income of anything above ten thousand dollars per annum to the holder thereof. One should include among these "professional students" the few who are interested in the executive accounting positions of certain of the larger corporations: the positions of auditor, Comptroller, cost accountant, or budget officer.

In our experience we have found still another type possessed of an interest in our C.P.A.-review course. This type is represented by the student who has little or no interest in accounting *per se*, be it public or

private, but who expects to use accountants' reports in discharging the duties of that executive position which, in his mind, is the goal toward which his present work is directed. This student desires a comprehensive review of accounting principles and practices and discovers from his catalog that such a review is offered only in the C.P.A.-review course.

The selection and presentation of material in this course will be influenced by several factors. Among these may be mentioned:

(1) The number of hours available in the curriculum.
(2) The number of students in the course or in each section of the course.
(3) The degree to which other courses in accounting tend to supply the needs of a C.P.A.-examination candidate.
(4) The text and other materials available.
(5) The provisions of the state's accountancy law relative to the conditions under which a person may take the C.P.A. examination.
(6) The experience, perhaps the attitude, of the instructor.

I have been asked to indicate briefly our procedure at the University of Iowa. In doing so it may be well for me to classify my comments under the points just enumerated.

Our course is a three-hour, one-semester course, offered during the second semester of the senior year. A peculiarity may be noted in the fact that the course is actually scheduled as two two-hour meetings. For the adequate discussion of certain problems, a one-hour meeting does not provide sufficient time. Certainly a one-hour session is inadequate for periodic tests or examinations. We have found the double hour particularly satisfactory because it increases the flexibility factor. As conditions warrant, the class is dismissed from time to time in order that its total class hours may be somewhat comparable to those in other commerce courses carrying three semester hours of credit. We regard the additional hour as a class hour, not as part of a laboratory period.

Our enrollment averages approximately fifteen students. This limited number offers an opportunity for a much more flexible course. The individual needs of the students can be more nearly satisfied than they could be if the enrollment were so much as doubled.

Students enrolling in the C.P.A.-review course must have a minimum of fifteen hours in prerequisite courses: elementary accounting, intermediate accounting, and cost accounting. Actually I do not recall any student who presented only this minimum. It is customary for the student to have, in addition to the foregoing, credit in accounting systems, one semester of the year course in auditing, advanced accounting, and a second course in cost accounting. Many have had either accounting theory or governmental accounting. Concurrently with his C.P.A.-review course the student enrolls for the second semester of auditing, managerial accounting and, probably, income-tax accounting. If he is not thoroughly saturated, it is scarcely the fault of the curriculum! Perhaps three of these courses offer material of particular interest to the C.P.A. candidate. The income-tax course and that in auditing fall into this group rather obviously. Our course in advanced accounting is devoted primarily to an examination of the accounting procedures and principles relative to holding corporations. In addition, however, this course embodies a discussion of many odds and ends: estates, foreign exchange, insurance, additional work on bankruptcies, receiverships, and reorganizations. Because of this situation we exclude from our C.P.A.-review course intensive work on subjects or phases concurrently treated in other courses. I do not mean that these subjects are excluded entirely but that they are likely to be minimized in favor of a fuller treatment of other items.

Text materials offer a perennial problem. It seems to me that these should be in a state of constant change. Obviously one can't abandon his materials *in toto* each year. Certain old problems will always be better media for conveying various bits of information than will any new problem of which the instructor chances to be aware at the moment. One collection of problems, one textbook, may appear more satisfactory to

a given instructor than does any other work in the field. It seems reasonable, then, that such a book might be continued for several years as the base on which the course may be built and rebuilt. Additional problem materials may be obtained from the current examinations of the American Institute of Accountants, from the examinations of the several State Boards of Accountancy, and, to a limited degree, from other sources. To prevent a too complete reliance on any one text or assortment of problems one may follow the self-imposed rule that an examination or quiz used in any one year is not to be repeated within three, four, or five years as the instructor chooses. We use a basic text. We use additional materials extensively. We do not repeat examination or quiz problems within three years. We permit the student to retain all quiz and examination materials.

In Iowa the law provides that the candidate in the C.P.A. examination must have at least three years' experience on the staff of a practising accountant. Two of these years are waived if the candidate has majored in accounting and received a degree from a recognized college or university. This means that our students cannot write the C.P.A. examination in Iowa for at least one year after graduation. Usually the period is somewhat longer because of the highly seasonal nature of the professional accountants' work. This legal restriction has dissuaded us from introducing into our review course such things as time trials. It removes entirely any special build-up sessions designed to prime the student for a C.P.A. examination.

Under the last point, that dealing with the experience or attitude of the instructor, one has a splendid opportunity to reveal his own idiosyncracies. That one's few virtues and many shortcomings lend themselves to any orderly exposition is highly doubtful.

To begin with, it seems that the C.P.A.-review course is usually in the hands of one or more instructors relatively high in the academic pile. These men are usually possessed of teaching experience and practical experience equal or superior to like experience among their colleagues. But along with the advantages of this experience come the disadvantages resulting from many repetitions, a possible unwillingness to adopt new methods, even some loss of interest in the work itself. I believe that the C.P.A.-review course should be rotated periodically among the staff members reasonably well qualified to offer the work.

The basic textbook selected should provide answers and solutions in loose-leaf form. I know of no substitute for the advantages inherent in a loose-leaf arrangement. It must be admitted that desirable texts with loose-leaf solutions available are relatively few in number and, if one is to change texts frequently, the list is soon exhausted. I do not believe that the use of bound solutions, available at the beginning of the course, is conducive to obtaining the best results. Students do not consistently solve problems for which they have at arm's length the author's solutions.

It seems to me that the course should be presented as an orderly review of the several principal parts or divisions of the work. With a small group, the instructor can go so far as to present chiefly those parts reflecting the greatest needs of his students. One should not give up entirely the matter of surprise problems. An intensive review of receivership accounts may well be interrupted by the introduction of a wholly unrelated problem in actuarial science, partnership dissolution, or income tax. The student should not be trained as a giver of curbstone opinions but he should not be permitted to lose sight of the fact that the professional accountant is likely to meet without warning in an examination or out, a great number of different problems.

I believe that much may be said for the increased use of relatively short problems, particularly those likely to be encountered as parts of longer problems. The statement of affairs may be used to illustrate my feeling on this point. Unquestionably most of us have solved dozens and dozens of these problems. Usually they are long and, except for given items, anything but intriguing. They are very much alike. The student may

well solve two or three of these problems in the C.P.A.-review course in order to refresh his memory. At this point, the long problem has, in my judgment, served its purpose. Additional long problems will be valuable primarily as they introduce new items. I believe that it is preferable to focus attention on the items themselves: the presentation of accrued interest on pledged assets, of partially finished goods which are to be sold or completed, of items enjoying unusual preferences, of wholly or partly secured claims. Other accounting statements will, as a rule, permit like illustrations. In this way much needless repetition can be avoided and, as a consequence, additional subjects can be covered.

At times I have been particularly well pleased with the results following my presentation of an erroneous solution of a problem. (Since I was *pleased* it may be assumed that the errors were introduced intentionally!) This has, on occasion, done much toward buoying a lagging alertness. It is something of a warning against taking too much for granted. Naturally one must appear reasonably open-minded as to the probability of errors in his solution. He must, for a time at least, defend it to the best of his ability. If the instructor becomes dogmatic he will stifle discussion and the trick, if it be a trick, will serve no good purpose. I admit freely that one may not always convince certain doubting Thomases that the errors were introduced intentionally. Those with great pride or large ego should avoid the experiment.

One other point: I have asked several teachers of review courses to comment on this question and I am not sure that there is, or likely can be, a consensus of opinion. Students are interested in knowing what the practicing accountant would do, what is the better answer, is it customary to do this or to do that? In like manner, students present alternative solutions for a given problem. One solution, it may be assumed, presents certain refinements rarely, if ever, suggested by the average practicing accountant. The other solution may be much more practical even though somewhat less sound theoretically. You have in your experience encountered these things. My question is: When shall the instructor define practice? Obviously he will, in many instances, know little or nothing about "practice." In many cases he will know that "practice" varies so widely as to be almost beyond description. Certainly, in many instances, he will know what the "practice" of several representative accountants is. One cannot succeed if his solutions are dogmatically justified by the word practice. I do not, on the other hand, hold with the instructor who refrains from "entering the argument," who permits students to attempt and infinitum the justification of a solution which, to one of the instructor's experience, is most impracticable. A preferable solution championed by a less aggressive student or by one less skilful in debate may be lost to the class unless the instructor comes to its defense. I believe that the class is as fully entitled to the experience of the instructor as it is to his time in the classroom. He cannot answer all questions which arise nor can he be equally satisfied with all answers in a given hour but he can be more than chairman of the meeting. His students, I believe, want and will appreciate having his best judgment on the many points which arise in a C.P.A.-review course.

THE WRITTEN REPORT IN ACCOUNTING SYSTEMS

C. E. Allen

In the teaching of accounting systems one finds that it is often difficult for the student to see the practical application of the accounting theories discussed in the classroom. No doubt this is due largely to the lack of practical experience on the part of the student. Some schools overcome this handicap by arranging for part time work in the accounting departments of local business concerns. Other schools find this arrangement impossible, due to the scarcity of such business concerns or the general policies of the college or university. This lack of experience may be at least partially overcome by means of the written report, which may be used to

supplement the course in accounting systems. In this report the undergraduate may select a business concern either in the college community or elsewhere, usually near his own home, and make a first hand study of the accounting system of that business.

This report may be required or it may be made optional, and, if satisfactory, it may be accepted in lieu of the final examination. In the writer's experience it has been found that a student does a better job and gets more out of it where the report is made optional and accepted in place of the final examination.

If a report of this kind is to be satisfactory, first the student must be advised as to the choice of the business, so that the work undertaken will not be beyond his capacity; and second, he must be directed as to the method of making the study and writing the report. It is in connection with the procedure in writing such a report that the outline below is suggested.

The outline is given to the student early in the semester and soon afterwards he is asked to name the kind of business in which he is interested and on which he would like to make a report. If the business selected is acceptable to the instructor and is within the capacity of the student, he is then given general instructions on how to make the approach and gather the material. As a rule very little difficulty will be experienced in getting permission to make such a study since those in charge of the business are not asked to divulge any financial information. In most cases the business man is quite willing to coöperate and is interested in helping the student make a good report. Often actual transactions and figures for illustrative purposes will be given voluntarily.

A report of this kind is worth while for several reasons. In the first place, it gives the student experience in meeting and talking with business men. Second, it affords him the opportunity to learn more about the business in which he is particularly interested. Third, it enables him to see an accounting system that is in actual operation, which will make the theories of the classroom seem more real.

The outline below is not exhaustive and it cannot be used in its entirety for every type of business; still, it is believed, that it will suggest to the student the subject matter that may be included in a written report as described above.

Outline for Written Report in Accounting Systems

I. Introduction
   1. Name and location of business
   2. General statement as to the nature of the business
   3. Form of business unit
   4. Size of business—total assets, capital, and sales, if available

II. General Operations of the Business
   1. Purchases
      a. Steps in the purchasing procedure from the time the request is made until the goods are received and stored or placed in the selling departments.
      b. Handling of freight and truckage on purchases
      c. Accounting for purchase returns and allowances
      d. Cash purchases
      e. System of stock control
   2. Sales
      a. Steps in the sales procedure from the time the sale is completed until the goods are shipped or delivered
      b. Accounting for delivery costs
      c. Methods of merchandise control in the shipping department and on delivery trucks
      d. Handling of sales returns and allowances
      e. Cash and C.O.D. sales
      f. Sales to employees
      g. Instalment sales
      h. Consignment sales
      i. Approval sales, and others
   3. Cash Disbursements
      a. Method of making payments to creditors and employees
      b. Handling of petty cash items
      c. Internal checks on cash disbursements
   4. Cash Receipts
      a. Handling of incoming receipts
      b. Methods of checking outside collectors
      c. Collections for C.O.D. sales
      d. Frequency of cash proof
      e. Internal checks on cash receipts

5. Miscellaneous Items
   a. Accounting for notes and acceptances both incoming and outgoing
   b. Accounting for extraneous income and expenses
   c. Mechanical devices and machinery used in accounting

III. Business Forms Used
   1. Name chief forms used and state purpose of each
   2. Submit actual forms or draw up copies
   3. Origin of forms
   4. Number of copies made and their disposition

IV. Books of Original Entry
   1. Purpose of each
   2. Draw up headings of each or submit actual form
   3. Illustrate by journal entry the posting from each

V. Chart of Accounts
   1. List the general ledger accounts, including account numbers or letters, if available
   2. Indicate the controlling accounts

VI. Financial Statements
   1. Draw up pro forma statements, including schedules
   2. Frequency of statements

VII. Bibliography
   1. Articles read
   2. Reference books used
   3. Names of individuals interviewed

PROBLEMS OF ACCOUNTING RESEARCH

OBJECTIVES ATTAINABLE THROUGH ACCOUNTING RESEARCH

S. H. Nerlove

Adopting Professor Henry Rand Hatfield's broad statement of the function of accounting, the possible objectives of accounting research are almost unlimited. Professor Hatfield once stated that the function of accounting is "to place responsibility, to prevent fraud, to guide industry, to determine equities, to solve the all essential conundrum of business: 'What are my profits', to facilitate the government in its fiscal operations, [and] to guide the business manager in the attempt to secure efficiency."

Obviously, in order to perform this function adequately it is essential for accountants to take full cognizance of the outstanding characteristics of modern business life, to develop and to use effectively available tools of analysis and to recognize in all respects their social responsibilities.

Accordingly, the possible objectives of accounting research may be grouped in three more or less interrelated categories:

(1) The realization of an adequate understanding of the relation between accounting and the structure and functioning of an ever-developing and capital-accumulating business enterprise system.

(2) The use and development of accounting tools of analysis, as well as the use that can be effectively made of other available tools of analysis whether they be actuarial, statistical, or economic-theory devices.

(3) The establishment of standards with reference to disclosing effectively all relevant information on financial statements issued to the public.

At any given time, of course, the specific objectives of accounting research that will fall in these three categories will necessarily be set up in view of any then current shortcomings of accountancy which may be evident. Consequently, I shall confine myself in this paper to a series of observations regarding the weaknesses of present-day accountancy which will readily bring to mind certain desirable objectives to be attained through accounting research.

Present-day accountancy appears to have at least three major roots of confusion and weakness which might well be eliminated to a considerable extent through research. The *first* is, that as yet the following two significant features of modern business life seem to have failed sufficiently to influence accounting:

(1) That business activity, as well as a system of business values, has its primary meaning in the character of a process, of a flow; and not in the character of wealth which exists at the moment and is often illusory.

(2) That business activity, particularly as it resolves itself in either profits or losses, is primarily a matter of making choices between alternatives.

If accounting took full cognizance of the first of these features, it would emphasize more than it now does the measurement and expression of income rather than that of wealth. Accountants would not tend to think of the balance sheet as the origin and goal of all accounting. Instead they would put primary emphasis on the income sheet. As a necessary consequence, almost all the items that appear on the balance sheet would be more carefully related to the profit-and-loss statement. Perhaps, too, periodic revaluations of many of the assets would be made in conformity with their income-contributing power. It might follow that considerable attention would be given to the relationship between the length of the accounting period and such problems as that of determining the distinction between a capital expenditure and a charge against revenue, between a cost and a loss, and between a recurring income and a nonrecurring income.

In addition, this shift in emphasis to the consideration of income rather than

wealth might bring to the fore the need, as Professor Paton put it, of "reducing to a common denominator accounting data originating on different price levels." Of course, it would tend to develop flow-of-funds statements. No doubt, with this changed point of view, cumulative reports portraying the development of business concerns over relatively long periods of time will be more often presented. And, finally, more attention would probably be given to the presentation of capital-account and current-account balance sheets.

Accounting, if it gave adequate consideration to the second of these features of modern business life, would treat the profit-or-loss results of alternative action, as well as the results of the choice made in a given situation. Such analyses as those contained on comparative statements would be much more frequently presented. For example, a case in point is a comparative statement of profit and loss showing the results obtained from selling a product in packages with heavy advertising expenses as against the results from selling the same product in bulk with practically no advertising expenses.

The *second* major shortcoming of accountancy arises out of the fact that the following two essential tools of analysis seem to have been underdeveloped:

(1) The principle of small increments

(2) The principle of separation by imputation

At the present time accounting is a method of measuring and interpreting business transactions primarily, if not solely, on "average-bases." For example, average costs are usually used and presented; values are practically always determined on the basis of average costs; and it is assumed throughout accounting analysis that value is the property of large quantities of commodities, no matter how large the quantity. May it not be essential for accounting to make more use than it does now of the first of the tools of analysis just mentioned—the principle of small increments? On the basis of adequate research of the matters involved, why not give full cognizance in accounting analyses to marginal costs, to the uncontrovertable business fact that salable value is not the property of a large body of a given commodity but rather the property of a relatively small portion of the available supply of that commodity, and to the fact that the value of a given commodity, whether it be a consumer's good or a producer's good, is not its average cost but rather a measure of its scarcity relative to and conditioning the need of that commodity by either consumer or producer?

In connection with these matters, income sheets would be developed that would show completely revenues from various sources, expenses of all kinds, income allocations and full surplus analyses. What is more, cost statements would be presented showing the cost per unit of output at different rates of output. Of course, two-section balance sheets showing some measure of liquidating values as well as going-concern values, would be more often used. And probably the development of statements showing operating ratios might well be more adequate and numerous.

The second tool of analysis suggested the principle of separation by imputation—might well be more often used by accounting than it is at the present time. Too often, accounting merely describes, classifies, and summates certain characteristics of business events. Accounting, as a method of analysis, might well develop ways and means of separating out and measuring either the specific profit or loss result of a particular increment of cause or the specific cause of a particular profit or loss. In other words, more attention should be given in accounting to analysis by imputation.

Illustrations of how these two tools of analysis can be used with reference to costs of specific industries can be found in a classic treatise by an economist, Professor J. M. Clark's *Overhead Costs*.

The *third* major shortcoming of accountancy, which I shall discuss briefly, is the deplorable lack of standards now existing with reference to disclosing adequately relevant and important information on financial statements issued to the public. This shortcoming can also be eliminated to a considerable extent by intensive research

into the merits of the various positions taken by accountants regarding the controversial matters involved. In this connection, the objectives of accounting research might well be such as the following: (1) to eradicate, if possible, the variety of ways in which contra valuation items modifying assets, liabilities and equities are shown; (2) to standardize the method of handling security discounts; (3) to establish standards for presenting adequately stock equities; and (4) to avoid the manipulation of the depreciation item. A longer and a much more complete list of such matters is presented by Professor E. L. Kohler, in his article "Needed: A Research Plan for Accounting."

By this time some of you, particularly those of you who feel that Professor Hatfield's statement of the function of accounting is too broad, have visions that if the above objectives of accounting research were accepted, accountants would be replacing economists, statisticians, and even actuarial scientists. Perhaps so, but I doubt it. Each one of these specialists has his own point of view, his own problems and his own techniques. Often, too, it would be exceedingly helpful if two or more of these specialists would tackle the same problem even though they might attempt to use identical tools of analysis. With the New Deal in view it is difficult to disagree with Professor Kohler when he recently said "a study of the trends within and without accountancy point to the constant enlargement of the accountants' responsibilities." With accountants becoming business advisers, exponents of good financial practice, and fiscal agents of stockholders, the objectives which I have suggested to be attained through accounting research, in view of certain shortcomings of present-day accountancy, may even be too narrow rather than too broad.

SOME PRINCIPLES FOR TERMINOLOGISTS

E. L. Kohler

Definition in its popular sense is the process of delimiting a concept or thing with the object of establishing that usage for a word or phrase which has a significance common to all persons. Definition is also popularly understood to be the *expression* through which the limits of the concept or thing are set up. Without definition, or with more than a single definition in common use, situations frequently arise where no exact medium of communication exists. Probably every person has had the experience of participating in protracted disputations only to discover in the end that he and his opponent had been talking different languages.

Within the realm of logic, definition has as its purpose the determination of the qualities of universals. A universal is conceived as being the essence of any logical genus or species made up of individuals or particulars; and the logician, concerned as he is with the reality of his universals, pays much attention to their development and mutual relationships. In a highly particularized field such as accounting, the introduction of logical principles carries with it the necessity of a careful formulation of concepts or universals: that is, the basic classes of groupings of otherwise unorganized subject matter. Without well-conceived universals, the application of any of the traditional forms of reason, which is often attempted in the field of accounting, leads inevitably to an unhappy result. Perhaps it is unnecessary to add that I assume that no one denies to the accountant the right to the use of logical processes.

Hence it may be said that the necessity of a common language and the necessity of building up an adequate background for the introduction of logical principles place upon us as accountants the burden of exploring thoroughly the requirements of good definition. We will be concerned to a great extent with logical definition, because we need to distinguish words used in accounting from their applications elsewhere. In so doing, we shall be exploring the mental notions of the accountant. But our efforts will be devoted also to the clarification of those words and expressions which relate to the accountant's physical activities and his connections with the outside world.

In brief, the basis of definition is to classify and differentiate. The classical proposition, *man is a rational animal*, is a happy illustration. "Man," a species, typifying all humans, while having characteristics of the broader genus of animals, differs from other animals by possessing the faculty of reason. Classified as an animal, man is distinguished from other objects or matter; having the faculty of reason he is limited to a certain class of animals. Definition is thus a step away from the general in the direction of the particular; but strangely enough, it never reaches the particular, for the particular can always be described in terms of the lowest or smallest subclass or species to which it belongs.

I should like at this junction to point out the relationship between definitions and standards. Definitions are standards; but standards embrace also the axioms and the particular variety of reasoning through which our performances must clear. There does not appear to be much difference between an axiom and a definition, especially in accounting, except that for the definition we substitute a single word or phrase. Both are assumptions. Both are starting points. Both provide us with working tools for the construction of theories, logical processes, and conclusions. Without them the instructor and the practitioner are leagues apart. To their formulation we can afford to spend much of our energies.

Considerations such as these lead us to the formulation of rules for the good definition:

(1) It must set forth the fundamental and unique attribute or attributes of all members of the class but of no other class.

(2) It may be stated in terms of the next larger class, thus avoiding a more elaborate differentia.

(3) If the class and differences of a term cannot readily be recounted, a *genetic* definition may be resorted to; that is, the sense of a thing may be gained from a knowledge of how it is produced.

(4) There must be no *circulus in definiendo*, or repetition of the term to be defined.

(5) Where the same meaning attaches to more than one word or term, preference should be given to one of them.

(6) Where a word has more than one meaning, the separate uses must be appropriately distinguished.

(7) Plain, direct language is highly desirable.

(8) A negative statement must not be used except where the positive has a clear disadvantage.

To illustrate these rules, let us select an example or two.

> *Effective rate:* the percentage obtained from dividing the income currently realized on an investment by the sum invested; distinguished from *nominal rate.*

From this we may gather that the essential attributes of effective rate are (a) that it is a percentage, (b) that it is obtained by dividing a specified income by a specified principal sum. The genus is the percentage; the differentia is the particular method by which it is obtained. The term *nominal rate* has the same genus but its differentia varies by having a principal sum of another order. It will be noted that this definition is closely related to the *genetic* variety because an effective rate will always be obtained by following the process indicated. Another feature is that a more elaborate definition has been avoided by reference to percentage, the next higher class. If this had not been done, it would have been necessary to make plain the significance of percentage and to call for the multiplication by 100 of the decimal fraction which the division yields. Finally we observe that the definition contains two secondary genera: (a) income of a certain variety and (b) investment. In this instance the primary genus, percentage, needs no special definition, for its usage is not confined to the field of accounting and may be found in the ordinary dictionary; but *income* and *investment* happen in themselves to be accounting terms which need elucidation. Should we define *income,* we would again introduce new genera.

As a second illustration I will choose the noun *account*, in order to demonstrate the

interrelationships of definitions. This word has three meanings, each of which finds everyday usage:

(1) a statement of business transactions; a statement of transactions between debtor and creditor.

(2) a summary of related business transactions built up or posted from a chronological record of transactions; such summaries are the basis for all bookkeeping and accounting.

(3) a financial statement (British usage only).

Now let us turn to the first word of the definition, *statement*, which appears to be of a higher order. How may it be defined?

Statement: a presentation of account names and amounts, usually in conventional order, or a summary of such accounts, prepared for the purpose of displaying financial condition, operating results, etc.

Another word appearing in the definition of account is business transaction. We find that a transaction is:

Transaction: an event occurring in a business enterprise giving rise to an increase or increases in one or more assets or equities and an equal decrease or an equal total of decreases in one or more of the other assets or equities. The event may take place as the result of deals with outside persons (a business transaction), or as the result of expirations of values or adjustments made necessary by the accruing of income or expense (an accounting transaction).

In defining transaction, we encounter new genera: business enterprise, asset, equity, deal, person, and so forth. These, in turn, must be defined. When our work on terminology is in its final stages I am going to suggest that someone prepare a study of the really basic concepts. One test of the results produced will be whether these basic concepts have been successfully interwoven with the concepts that have presumably been derived from them.

I am one who believes that there is no difference between the theory and the practice of accounting. So fixed is this belief that I have never been able to discover any practical judgments or everyday performances of the practitioner than cannot be described in terms of the classroom. The conscientious practitioner at all times follows good theory; if he adopts a procedure differing from that appearing in our texts he merely finds his own theory superior to ours. Needless to say either or both may be wrong in the judgment of someone else. It depends on the third person who sits in judgment.

It is this fixed idea that brings me to the conclusion that in seeking to bring the classroom closer to the profession, no greater impetus can be given than to establish at the earliest possible date a language which may be understood by both. May I not urge that when the time comes for your coöperation, you will lend to your profession your best efforts?

THE MASTER'S THESIS

H. C. Miller

Through the coöperation of some of the members of this association a list of accounting theses for a master's degree has been compiled. Requests for titles approved during the past five years were sent to 46 universities represented in The American Association of Collegiate Schools of Business. Thirty-eight answers were received. Ten of those replying indicated that no graduate work in accounting, as a major field, has been done. Four more indicated that the thesis requirement has been abolished or waived. Twenty-four replies listed titles numbering more than 415, but the excess over that number represented subjects approved prior to 1929, doctors' dissertations, or bachelors' honors reports. For the purpose of this study these excess items have been disregarded.

The 415 recent thesis titles listed by 24 universities came from all parts of the United States. The geographical distributions (1) of the universities contributing to this list and (2) of the titles are as follows:

Section	*Number of Universities Reporting Accounting Theses*	*Number of Theses Reported*
New England	2	31
Middle Atlantic	6	149
South	2	18
Middle West	8	163
Western Plains	3	12
Southwest	1	24
Pacific Coast	2	18
Total	24	415

The 415 titles are divided into two groups consisting of 321 theses finally approved, and 94 theses tentatively approved and now in progress. These figures may be significant as an index to the growth of graduate work in accounting. If we may assume that a master's thesis is normally completed within a year after the subject has been tentatively approved it would appear that during the past five or six years the average number of theses completed annually has been between 54 and 64. But this year 94 theses are in progress. This implied conclusion to be drawn from this accelerated production of masters' theses in accounting is interesting even if the reasoning is slightly forced.

Quantitatively, it may be said that we are assembled near the geographic center of thesis work in accounting. One might even hazard a declaration that we are on the doorstep of the capitol building for graduate work in accounting. Of the 415 theses listed, 129 were supplied by three universities, two located in this metropolitan district and the third situated some miles southward in the provinces of this great state. In justice we must reluctantly admit, however, that three universities in the environment of New York City contributed 131, while the remaining 155 came from the scattered precincts of the Great American Wilderness. Making a serious bid for the Nobel World Peace Prize the writer refrains from any qualitative comparisons lest we start a civil war of unknown consequences!

How much should we expect of candidates for the master's degree? This is a question to which all graduate advisers seek an answer. Granting that the candidate is educationally immature, we should not overlook the fact that his thesis work represents his first attempt at anything more formal than an ordinary term report or honors essay. Any required reports in graduate seminars are frequently concurrent with the initial steps toward the preparation of the thesis. We can, therefore, expect only certain requisites which the candidate may be expected to bring from his undergraduate curriculum. Many undergraduate students will complete the requirements for a baccalaureate degree without acquiring these requisites for successfully pursuing graduate work. It is a mistake to assume that every person who receives a bachelor's degree is qualified to undertake graduate work with expectation of receiving a master's degree. The graduate school administrators in one university, recognizing this principle, have adopted a policy of collecting instructor's opinions of graduate students. In some cases, unfortunately, it will become necessary to inform an individual that he may continue to take courses open to graduate students but that there can be no expectation of eventual candidacy for a degree in the Graduate School. It appears to the writer that the necessary requisites for carrying graduate work to a successful conclusion, in addition to the mere holding of a baccalaureate diploma, are:

(1) Knowledge of good grammar.

(2) Ability to express thoughts concisely, pointedly, and clearly.

(3) Logical thinking.

(4) Familiarity with library methods.

(5) Developed imagination, intellectual curiosity, initiative and resourcefulness.

(6) Independence of thought.

College graduates who lack all of these requisites may be rare. College graduates who lack one or more of these requisites are not rare. Another essential element to be expected before beginning the master's thesis in accounting is a thorough knowledge of underlying accounting principles. If this has not been acquired as part of the undergraduate training the student must be informed that real graduate level work can-

not begin until the deficiency has been made up. Elementary, intermediate, and advanced or special courses such as cost accounting, auditing, income tax, budgeting, accounting systems and problem review must be made a part of the equipment of the graduate accounting student who would carry on research in his chosen field.

Probably nothing which the average graduate student must do is as difficult for him as the selection and statement of his thesis subject. It is well that he must, for once in his life, make a decision without help. (The graduate adviser's help is mostly of a negative variety. The young research worker must be plunged immediately into an aggressive campaign. Say "No" to his proposals until he can convince himself that he is right.)

"What is a satisfactory thesis subject?" It appears that this is another question to which we need the answer. In order to make clear the need for a definite statement of standards certain of the thesis subjects listed will be used as illustrations of a lack of uniformity. Let no one believe however that the writer advocates a deadly uniformity of standards for graduate thesis work. Also, let it be understood that any criticism made, herein, is not intended as personal criticism of any adviser who may have approved the subjects selected for illustrative purposes. Progress must come through frank, unimpassioned, and critical scrutiny of what we are doing. Comparisons of approved subjects should be accepted in the same spirit as though the critic were criticising what might have been his own work.

It must be admitted that frequently the stated title of a thesis does not adequately define the intended limits. Hence a criticism based upon the stated title may not be appropriately applied to the thesis or to the work done by the candidate.

Let us compare two subjects which have only tentative approval and which are now in progress in two universities here in Chicago.

1. Accounting for Banks
2. Cost Analysis for the Service Charge on Demand Deposits for Small Banks.

The first subject appears to have unlimited breadth:—accounting for banks, large and small, national, state and private, commercial and savings, with and without trust departments. The second subject is quite limited. First it deals only with small banks. Second it seems to be limited to commercial banks by the words "demand deposits" thereby excluding time or savings deposits. Third it deals only with that phase of accounting which is related to "cost" and the "service charge." If one graduate student can find enough to do with these limitations, the other graduate student must certainly face a stupendous task unless his research is to be confined to the surface. Quite naturally one research worker may prefer to explore horizontally. Another may prefer to explore vertically. Our task as faculty advisers is to insist upon a reasonable balance of depth and breadth.

Now let us compare three subjects which were given final approval, two in eastern universities and one in a western university.

1. Accounting for Municipalities
2. Accounting for Middle-Class Municipalities
3. Investigation of Accounting Methods of Town of North Bergen, N. J.

Again the first subject appears to have unlimited breadth. The second subject limits the study to "middle-class municipalities." The third subject deals only with one, doubtless small, political subdivision. If the graduate student dug deeply into the accounting for this one small political subdivision, what would you say the other two students did, one with all the numerous "middle-class municipalities" and the other with any and all kinds, types, and varieties of municipalities?

Here are a few more pairs, trilogies, or what not:

Two eastern universities; subjects finally approved—

1. Depreciation
2. The Sinking-Fund Method of Depreciation

A middlewestern university and a southern university; two subjects approved tentatively—

1. Accounting for State Universities
2. Revision of the Accounting System of the University of Missouri
3. Accounting for a University Library.

An eastern university, a middlewestern university, a southern university; two subjects finally approved, third subject tentatively approved—

1. Accounting for Wholesalers
2. Accounting for Wholesale Food Industry
3. General Accounting Systems for a Wholesale Paper Company.

An eastern university, and a southwestern university; both subjects finally approved—

1. Auditing
2. Internal Audit Control for Texas Counties.

An eastern university, a middlewestern university, and a southern university, all subjects finally approved—

1. Standard Costs
2. Standard Costs for Engravers
3. Accounting for Material Price Variances in a System of Standard Costs.

These are only a few illustrations selected at random from the list of 415 theses in accounting. Do you think that the lack of a uniform standard for accepting thesis subjects is evident?

Here is another indication of lack of uniformity. A master's thesis title reads: "An Accounting and Statistical Analysis of The Fox Film Company." Still another reads "An Accounting Analysis of Chrysler Corporation." Without any desire to make derogatory criticism, I am compelled to say that these titles sound very much like a required term paper in an undergraduate course devoted to "Businesss Statements, Their Analysis and Interpretation." Possibly the master's thesis is appropriate, possibly the term paper is appropriate, the differences *may not* appear in the titles. I wonder!

"How diversified is the work in which we permit our candidates to engage?" A rough answer to this question has been attempted by a somewhat arbitrary and not wholly satisfactory classification of 415 thesis subjects. It will readily be realized that classification from the titles alone is difficult. Furthermore an acceptable classification of accounting thesis subjects has apparently not been developed. The classification is therefore presented with apologies on the next page.

If we accept, for the moment, this classification as sound, what is to be said of our wisdom in permitting so many graduate students to work on accounting systems? Out of 415 subjects, 71 were on accounting systems of specific corporations, industries, or associations. An additional 19 were on cost accounting systems. Are we justified in doing so much in this direction? Nearly 22 percent of thesis work appears to be in the field of accounting systems. What are these theses? Are they masterpieces of descriptive literature or do they bear silent, yet eloquent witness to the labors of a neophyte in his first research struggle?

Accounting systems claim 90 out of 415 titles. Statistical and Financial Analyses and Miscellaneous Problems in Cost Accounting claim 32 and 31 titles respectively. These classifications include 153 titles or over 36 percent of all the titles listed. Is this because we, as faculty advisers, believe that the best opportunities for research lie here? Or is it because we have no standards for graduate research? Does it not seems strange that only 18 titles out of 415 deal with accounting and related fields? Are the boundaries of accounting knowledge so well defined that graduate students need not attempt explorations into the twilight zone—that no-man's land which lies somewhere out there beyond and reaches far over toward the land of the economic, financial, legal, marketing, and statistical Munchkins? Does it not seem strange that, during the past five years of depression and new price levels, only fourteen titles are found under the heading "Appreciation and Valuation" and only five titles are found under the heading "Price Levels"? Out of 94 theses now in progress not one seems to be devoted to "Standard Costs" or to "History of Accounting"!

Are we sacrificing research ideals for a dismal mess of onions? Are we permitting our graduate students to concentrate in an almost barren intellectual field, hoping to

CLASSIFICATION OF ACCOUNTING THESIS SUBJECTS

	Total number of titles included	*Number of titles in progress*
A. Accounting Education	10	5
B. Accounting and Auditing for Banks and Building and Loans	9	2
C. Accounting and Related Fields	18	2
D. Accounting Systems of Specific Corporations, Industries, or Associations	71	16
E. Accounting Theory—Depreciation, Goodwill, Contingent Liabilities	12	3
F. Appreciation and Valuation	14	2
G. Auditing and Auditors' Responsibilities	17	2
H. Balance Sheet—Classification of Assets and Liabilities, Analysis, and Presentation	11	0
I. Budgets and Control Through Accounts	17	2
J. Capital Stock, Surplus, and Accounting as an Aid to Stockholders	6	1
K. Chinese Accounting	2	0
L. Fiduciaries and Decedents' Estates	5	1
M. Cost Accounting Systems	19	4
N. Miscellaneous Problems in Cost Accounting	31	15
O. Standard Costs	14	0
P. History of Accounting	5	0
Q. Income Tax—Federal and State	19	8
R. Machines and Mechanical Aids to Accounting	12	5
S. Mergers, Consolidations, and Holding Companies	5	1
T. Price Levels	5	2
U. Statistical and Financial Analyses—Graphic Methods	32	5
V. Special Accounting Problems of Specific Enterprises	22	4
W. Theory and Practice	28	7
X. Miscellaneous—Professional Societies, Balance Sheet Items, Interest as a Cost, Voucher System, etc.	19	4
Y. Unclassified	12	3
Totals	415	94

stumble upon a golden nugget? Will our graduate work starve within the sight of plenty because of a greed for that which will neither satisfy, nourish, or develop the intellectual curiosity, nor prepare those now blundering along to subsist themselves when left without guide or compass?

Dr. John B. Canning has said: "The earlier college texts, too, were largely manuals of procedure written rather for the bookkeeper and the ambitious junior clerk than for the college student. Nor can it be said that this beginning is a matter of the past; for the early patterns are all too plain in the annual product of those writing today. With the exception of a few notable books, the emphasis is still heavily upon procedure rather than upon systematic analysis; and even that which purports to be analysis of the problems of enterprise is often no more than a crude dismembering of the enterprise operations."[1]

The development of standards for acceptable thesis work in accounting rests in the hands of members of this association. Practitioners have worked on a classification of their services to clients. Is it too much to expect that we who are engaged in directing research should develop a classification of fields and a definition of standards? Already, it appears that graduate work in accounting leading toward the doctor's degree is on the horizon. If effective work in directing more advanced research effort is to be brought to the task ahead, we must improve that which we are engaged upon at the present.

[1] The Economics of Accountancy, p. 3.

In closing, I cannot refrain from saying that we need not apologize to anyone for our work as graduate advisers. The accounting thesis titles listed and those used in this paper as exhibits to prove a lack of uniform standards, are quite as respectable as many which may be found in other departments. I have not yet seen an approved title reading

"Accounting for An Ethiopian Gentleman's Woodpile."

But not so long ago I read one which was approximately

"The Educational Behaviorism of a Nightcrawler, Common Variety."

MASTERS' THESES IN ACCOUNTING

(Asterisked titles in progress December 1934)

A. *Accountancy Education*

1. A Study of Introductory Accounting Texts as to Content and Method	Columbia University
2. A Survey of the Content of College Texts on Introductory Accounting	University of Illinois
3. The Contribution of High School Bookkeeping to Success in College Accounting*	University of Minnesota
4. An Analysis of the Business Courses in Small Liberal Arts Colleges	University of Illinois
5. Bookkeeping Syllabus in Chicago High Schools*	Northwestern University
6. Commercial Curricula and Bookkeeping Courses in Chicago High Schools	Northwestern University
7. Use of Office Equipment in Secondary School Commercial Teaching*	University of Chicago
8. Problems in the Teaching of Bookkeeping in Nebraska High Schools	University of Nebraska
9. An Analysis of the Overlapping Between Secondary School Bookkeeping and First Year College Accounting*	University of Chicago
10. Nature of Overlapping in Senior High School Bookkeeping, Commercial Law and Economics*	University of Chicago

B. *Accounting and Auditing for Banks and Building and Loans*

1. Accounting for Banks*	Northwestern University
2. Bank Audits and Examinations	Northwestern University
3. Savings Bank Auditing Manual	New York University
4. Building and Loan Audits and Examinations	Indiana University
5. Accounting for Building and Loan Associations Under the Serial and Terminating Plans	Ohio State University
6. Internal Bank Auditing	University of Texas
7. Cost Analysis for the Service Charge on Demand Deposits for Small Banks* (classification "N" also)	University of Chicago
8. The Development of Cost Finding Methods for a National Bank with Resources of Ten Million Dollars (classification "N" also)	University of Chicago
9. Application of Cost Principles and Statistics to Banking (classification "N" also)	Syracuse University

C. *Accounting and Related Fields*

Economics, Finance, Law, Marketing, Mathematics and Statistics

1. Differences in Cost Concepts Between Accounting and Economics*	New York University
2. Economic and Accounting Concepts of Cost	University of Illinois
3. Economics and Accounting of Industrial Selling	Boston University
4. The Economics of Merchandise Turnover	New York University

5.	Bankruptcy Reform From the Point of View of Accountancy and Finance	College of the City of New York
6.	Theory of Reserves in Finance and Accounting	University of Illinois
7.	A Survey of the Accounting Problems in Corporation Finance	University of Illinois
8.	A Survey of the Accounting Problems in Corporation Finance	University of Illinois
9.	Some Accounting Problems in Corporation Legislation in the United States	University of California
10.	Books of Account as Evidence in New York	College of the City of New York
11.	Use of Accounts Books and Business Records as Evidence in Court	New York University
12.	Accountancy in Federal Courts	University of California
13.	The Law and Accounting for Fiduciaries	University of Texas
14.	The Title Rule as Applied to Inventories	Columbia University
15.	A Discussion of Some of the Legal and Accounting Aspects of Treasury Stock	University of Illinois
16.	Accounting Aids in the Management of Marketing Activities*	University of Texas
17.	Mathematics in Accountancy	College of the City of New York
18.	The Relation of Accounting to Statistics	University of Illinois

D. *Accounting Systems of Specific Corporations, Industries or Associations*

1.	The Accounting System of the Alabama Power Company	University of Chicago
2.	Accounting for Automobile Dealers	Northwestern University
3.	Bituminous Coal Mining Accounting	Northwestern University
4.	Coöperative Apartments	University of Chicago
5.	Accounting for Cotton Merchants	University of Alabama
6.	Accounting Plan for the County*	Northwestern University
7.	A Survey of Accounting Records and Procedures of County Governments in Alabama	University of Alabama
8.	Accounting System for a Credit Union	New York University
9.	Department Stores, Accounts and Systems	College of the City of New York
10.	Department Store Accounting	New York University
11.	An Accounting System for Chain Department Stores	University of Oregon
12.	Accounting for Educational Institutions	Washington University
13.	Accounting for Buildings and Grounds Activities in Educational Institutions* (classification "V" also)	University of Chicago
14.	Accounting System for Electrical Manufacturing Business*	New York University
15.	An Accounting System for a Factory and Mill Supply Jobber	Dartmouth College
16.	Forestry Accounting*	Syracuse University
17.	Foundation Accounting	Boston University
18.	Accounting for Fraternities and Sororities	Boston University
19.	College Fraternity Accounts and Finances	University of Illinois
20.	A Study of an Accounting System for a Retail Furniture Chain	New York University
21.	Accounting Practice and Records of Instalment Sales of Personal Property (with Special Reference to the Furniture Industry) (classification "V" also)	Northwestern University
22.	The Management and Accounting for a Gas Utility	University of Texas
23.	The Practical Application of Accounting Principles to the Granite Industry	Boston University
24.	Accounting System of the Gulf States Paper Corporation	University of Alabama
25.	Accounting for an Import Commission House	New York University
26.	Accounting for Investments	University of Illinois

27. Accounts of an Investment Trust	Boston University
28. Mail-order Procedure Comparative Systems of Accounting	Boston University
29. Accounting for a Mutual Life Insurance Company*	Northwestern University
30. A Critical Survey of the Organization and System of Accounts Used in Lane County	University of Oregon
31. Accounting Methods and Control for Live Stock Coöperative Marketing Associations	Ohio State University
32. Accounting for the Lumber Industry	University of Chicago
33. Accounting for a Medical Clinic*	Washington University
34. Accounting for Municipal Departments	Syracuse University
35. Accounting for Municipalities	University of California
36. Accounting for Middle Class Municipalities	Columbia University
37. An Original Accounting System for an Oil Company	University of Denver
38. Cost Accounting for Oil Refineries (classification "M" also)	Ohio State University
39. Accounting for the Petroleum Industry*	Louisiana State University
40. Poultry Farm Accounting	Louisiana State University
41. Real Estate Accounting	Columbia University
42. Accounting in a Real Estate Management Corporation	New York University
43. Restaurant Accounting*	New York University
44. Accounting for Chain Restaurants*	New York University
45. A Uniform Accounting System for Retail Drug Stores	Indiana University
46. Accounting System for a Retail Lumber Company	New York University
47. Accounting System of a Smoke Fish Industry	New York University
48. Uniform Financial Accounting for Schools in Illinois*	Northwestern University
49. Public School Accounting	University of Nebraska
50. Uniform Administrative Accounting for Public Schools (1932)	University of Denver
51. Unit Cost in Public School Accounting (classification "N" also)	Ohio State University
52. Accounting as Applied to the Administration of Private Secondary Schools*	Boston University
53. An Adaptation of a Proposed Standard Accounting System for Colleges to Schools Outside the United States as Exemplified by Application to the Accounts of Silliman Institute*	University of Chicago
54. An Accounting Study of Stell Hall	Dartmouth College
55. Accounting System for Steam Laundries	New York University
56. Stock Brokerage Accounting	New York University
57. Accounting for a Testing Laboratory	College of the City of New York
58. Accounting for a Texas Rice Mill	University of Texas
59. Investigation of Accounting Methods of Town of North Bergen, N. J.	New York University
60. Trust Accounting	University of Chicago
61. Corporate Trust and Agency Accounting	Columbia University
62. Accounting for Trust Companies	Washington University
63. University Accounting	Boston University
64. Revision of the Accounting System of the University of Missouri*	Northwestern University
65. Accounting for a University Library*	Louisiana State University
66. Accounting for State Universities	Northwestern University
67. A Survey of the Accounting System Used by the Walgreen Drug Company	Northwestern University
68. Lumber Accounting with Special Reference to the Warland Lumber Company*	Northwestern University
69. Accounting for Wholesalers	Ohio State University
70. Accounting for Wholesale Food Industry*	Louisiana State University
71. General Accounting Systems for a Wholesale Paper Company	New York University

E. *Accounting Theory—*
Depreciation, Goodwill, Contingent Liabilities

1. Depreciation	Columbia University
2. Depreciation*	Northwestern University
3. Accounting for Depreciation	College of the City of New York
4. Methods of Accounting for Depreciation	University of Pennsylvania
5. Depreciation as a Problem in the Management of Business Enterprises*	Boston University
6. A Critical and Comparative Analysis of Different Methods of Figuring Depreciation	University of Missouri
7. The Sinking-Fund Method of Depreciation	College of the City of New York
8. Goodwill	College of the City of New York
9. Accounting for Goodwill in Partnership	College of the City of New York
10. The Amortization of Goodwill	College of the City of New York
11. An Accounting Study of Goodwill in Business	Columbia University
12. Accounting for Contingent Liabilities*	University of Missouri

F. *Appreciation and Valuation*

1. Appreciation of Assets	New York University
2. Appreciation, Accounting and the Law (classification "C" also)	University of Illinois
3. Appreciation of Assets and its Relation to Dividends	University of California
4. The Appreciation Dilemma	University of Illinois
5. Accounting for Appraisals	University of Texas
6. Interest Factor in Valuation	Louisiana State University
7. The Theory of Valuation Accounts	University of Illinois
8. Responsibility for Valuation	University of Illinois
9. Theories of Balance Sheet Valuation	Columbia University
10. Valuation of Assets	University of California
11. Inventory Valuations and Fluctuating Price	University of California
12. Valuation of Real Estate*	University of Chicago
13. The Mathematics of Real Estate Valuation*	University of Texas
14. Valuation of Oil and Gas Wells, Timber Tracts, and Coal Mines	University of Texas

G. *Auditing and Auditors' Responsibilities*

1. Auditing	Boston University
2. The Auditor: His Qualifications and Responsibilities	Columbia University
3. Legal Responsibilities for Public Accountants	New York University
4. The Legal Liability of Accountants in The United States and England	College of the City of New York
5. Rights and Obligations of Auditors and the American and British Legal Systems	New York University
6. The Adaptation of Auditing Procedure to a Classification of Audit Services	University of Illinois
7. New Securities Act of 1933 in Relation to Both Public Accountants and Accountants Within Investment Banking Houses	New York University
8. Liability of the Accountant Under the Securities Act of 1933*	Columbia University
9. Auditors Responsibility for Current Assets	New York University
10. The Auditor's Responsibility in Respect to Inventories	University of Illinois
11. Accountant's Reports	Columbia University
12. Recent Criticisms of Auditor's Certificates	University of Illinois
13. Stockholders Audit* (classification "J" also)	University of Chicago
14. Auditing Procedure for College and University Accounts	New York University

15.	Internal Audit Control for Texas Counties	University of Texas
16.	A Survey of the Development and Administration of County Fiscal Affairs in Texas in Relation to County Auditing	University of Texas
17.	Auditing for Social Service Institutions	New York University

H. *Balance Sheet—*
Classification of Assets and Liabilities, Analysis, Presentation, etc.

1.	A Study of the Balance Sheet Presentation	Indiana University
2.	Analysis of Balance Sheets for Credit Purposes	College of the City of New York
3.	Financial Statements for Credit Purposes	College of the City of New York
4.	The Adequacy of Financial Statements in Forecasting Insolvencies	College of the City of New York
5.	A Legal Analysis of a Balance Sheet	Columbia University
6.	The Development of the Balance Sheet	University of California
7.	Classification of Assets and Liabilities in the Balance Sheet	University of California
8.	Theories of Balance Sheet Classification	University of Texas
9.	Financial Reports of English Corporations	University of California
10.	The Effect of Purpose on the Balance Sheet	University of Illinois
11.	A Critical Survey of Corporate Statements to Stockholders	University of Illinois

I. *Budgets and Control Through Accounts*

1.	Control Through Accounting in the Independent Wholesale Bakery	Northwestern University
2.	Budgetary Control	Washington University
3.	Budgetary Control, Its Origin and Business Applications	University of Missouri
4.	The Development of the Principles and Technique of Budgetary Control	Columbia University
5.	Budgetary Procedure and the Control of Overhead	Northwestern University
6.	Budgetary Report Forms	University of Texas
7.	A System of Accounting and Budgetary Control for a College Operating Auxiliary Departments	Northwestern University
8.	Accounting and Control in a Retail Department Store*	Northwestern University
9.	Budgetary Control in Department Stores	University of Illinois
10.	Department Store Budgeting	University of Pennsylvania
11.	Food and Restaurant Control in Hotel Accounting	University of Pennsylvania
12.	The Budget System of the Government of the Philippine Islands	Northwestern University
13	A Variable Budget for a Paper Mill*	University of Chicago
14.	Sales and Distribution Expense Budgets	Columbia University
15.	Budgetary Control in the Shoe Industry	Boston University
16.	The Budget as the Central Instrument of Financial Direction and Control in State Administration	University of Pennsylvania
17.	The Function and Organization of the Controller's Department	Ohio State University

J. *Capital Stock, Surplus, and Accounting as Aid to Stockholder*

1.	Accounting for the Stockholder*	Columbia University
2.	Accounting as an Aid to the Stockholder	Columbia University
3.	Variations in the Handling of the Capital Stock and Surplus on Industrial Balance Sheets	Northwestern University
4.	Accounting for no Par Value Capital Stock	University of California
5.	Analysis of Surplus	Louisiana State University
6.	Some Problems in Accounting for Corporate Surplus	University of Missouri

K. *Chinese Accounting* (classification "B" also)

1.	American Bank Accounting in Its Applicability to Chinese Conditions	Syracuse University

2. Evolution of Chinese Bank Accounting	New York University

L. *Fiduciaries and Decedents' Estates*

1. Decedents' Estate Accounting and Tax	College of the City of New York
2. The Settlement of Estates—Accounting Principles and Law with Reference to Accounting in the Settlement of the Estates*	Boston University
3. Fiduciary Accounting	Columbia University
4. Inheritance and Taxation Accounting Under the Laws of New York State	College of the City of New York
5. Accounting for Decedents' Personal Estates in Ohio	Ohio State University

M. *Cost Accounting Systems*

1. Cost Accounting for a Cotton Mill*	Louisiana State University
2. Cotton Seed Oil Mill Cost Accounting	Northwestern University
3. Foundry Accounts and Their Use by the Management	University of Illinois
4. Analysis of the Cost of a Granite Shed	Dartmouth College
5. A Cost Accounting System for the White Knitting Company	Dartmouth College
6. Cost Accounting for a Lead Refinery	Northwestern University
7. Cost Control for the Leather Glove Industry	New York University
8. Cost Finding in the Lithographic Industry	College of the City of New York
9. Design and Installation of a Cost Accounting System in a Manufacturing Establishment*	University of Chicago
10. A Cost System for a Metal Stamping Factory	Northwestern University
11. Product Costs of an Oil Refinery*	Northwestern University
12. Paper Mill Cost Accounting	University of Chicago
13. Plating and Japanning Costs in a Job Order Industry	Northwestern University
14. Cost Accounting for a Public School System	University of Minnesota
15. Cost Accounting for Public Works of Municipalities*	Northwestern University
16. Process Costs for a Tile Manufacturing Company	New York University
17. Uniform Accounting Systems with Special Reference to Cost Accounting	Northwestern University
18. Cost Finding and Accounting Plan for the Wooden Box Industry	College of the City of New York
19. A Cost System for Carter and Rogers Woolen Mill	Dartmouth College

N. *Miscellaneous Problems in Cost Accounting*

1. An Analysis of Advertising and Selling Costs in an Oil Company*	University of Chicago
2. Accounting Viewpoints of Burden Application Bases	University of Illinois
3. Accounting for By-products	University of Texas
4. Accounting for By-products*	Louisiana State University
5. Distribution Costs	University of Texas
6. Distribution Costs*	Washington University
7. Distribution Cost Accounting for Meat Packers	Northwestern University
8. Allocating Expenses to Bread and Cake Departments in Wholesale and House-to-House Bakeries	University of Pennsylvania
9. A Proposed Modification of the Methods of Determining and Analyzing Distribution Costs	University of Illinois
10. Cost Analysis and Control of Marketing Expense	University of Pittsburgh
11. Analyzing Cost of Selling Packing House Products to Retailers	University of Chicago
12. Problems in the Application of Uniform Cost Accounting Methods in the Electrical Manufacturing Industry*	Dartmouth College
13. Methods of Factory Control: A Case Study	New York University

14. Hospital Cost Analysis: A Description and Analysis of a Simple yet Reasonably Accurate Method of Measuring the Costs of the Various Hospital Revenue Departments	University of Chicago
15. Overhead Costs in Hospital Accounting	University of Illinois
16. Cost of Idle Plant Capacity*	New York University
17. Joint and By-products*	New York University
18. The Effect of the National Industrial Recovery Act on Cost Accounting	Boston University
19. N.R.A. and Costs*	New York University
20. Office Costs*	New York University
21. The Treatment of Fixed and Proportionate Expenses in Financial and Cost Control (A Case Study in a Paper Mill and Power House)	Northwestern University
22. Cost Accounting and Price Policies*	New York University
23. Costs and Prices in Relation to Sweet Orr and Over-alls Industry*	New York University
24. Cost-Price Relationship of the United States Steel Corporation*	University of Chicago
25. Cost-Price Relationship in the Steel Industry*	University of Chicago
26. Recent Tendencies in Cost Accounting Theory	University of Illinois
27. The Scrap Problem	New York University
28. Analysis of Service Departmental Costs	University of Texas
29. Uniform Costs and Trade Associations*	New York University
30. Accounting for Waste and Scrap*	New York University
31. Cost Accounting and Its Relation to Engineering and Management*	New York University

O. *Standard Costs*

1. An Analysis of Standard Costs	Syracuse University
2. Standard Costs as an Aid to Efficient Production	University of California
3. Standard Costs	Louisiana State University
4. Standard Costs	Washington University
5. Standard Cost Accounting	Columbia University
6. Standard Manufacturing Costs	Northwestern University
7. Standard Costs in Manufacturing	Boston University
8. Standard Costs for Engravers	University of Pennsylvania
9. Standard Cost Reports for Executives	University of Texas
10. Accounting for Material Price Variances in a System of Standard Costs	Northwestern University
11. The National Retail Lumber Dealers Association—Standard Cost System	Columbia University
12. The Determination and Elimination of Production Variances in Standard Costs	University of Pennsylvania
13. The Operation of a Standard Cost System in a Rubber Footwear Factory	Boston University
14. Relation of Standard Costs and Budget Costs in Manufacturing Industries	University of Illinois

P. *History of Accounting*

1. Early Development of Financial Statements	University of Illinois
2. The Historical Development of Bookkeeping in the First Half of the Nineteenth Century	University of Illinois
3. The Historical Development of American Bookkeeping in the Last Half of the Nineteenth Century	University of Illinois
4. Development of American Bookkeeping from 1900 to 1930	University of Illinois
5. History of Accounting	Columbia University

Q. *Income Tax—Federal and State*

1. Accounting Theory as Developed by the Income Tax Rules and Regulations*	Columbia University
2. Income Tax Avoidance	University of Illinois
3. Federal Income Tax—Losses on Bad Debts*	University of Nebraska
4. A Comparison Between the Current Income Tax Laws of Great Britain and the United States	University of Illinois
5. A History of Consolidated Statements Under the Federal Internal Revenue Acts*	Northwestern University
6. The Use of Standard or Uniform Depreciation Rates as Proposed by the Bureau of Internal Revenue	Columbia University
7. Depreciation from the Standpoint of the Federal Income Tax Law	University of Pennsylvania
8. Federal Income Tax—Depreciation and Obsolescence*	University of Nebraska
9. Depreciation Policies Acceptable for Income Tax Purposes as Reflected by Decisions of the Board of Tax Appeals*	University of Chicago
10. Federal Income Tax—Goodwill*	University of Nebraska
11. Studies in Income Tax Problems	Washington University
12. A Simplified Procedure for Preparing an Individual Income Tax Return	University of Illinois
13. Real Estate Transactions and the Income Tax	Northwestern University
14. Real Estate Transfers and the Federal Income Tax	University of Nebraska
15. Basis for Income Tax of Assets Acquired in Connection with Corporate Reorganization*	Northwestern University
16. Income Tax Report*	New York University
17. Sales and Exchanges Under the Successive United States Income Tax Acts	University of Illinois
18. A Comparative Study of State Income Tax Laws from an Accounting Standpoint	Northwestern University
19. A Critical Study of the Illinois Personal Income Tax Law	University of Illinois

R. *Machines and Mechanical Aids to Accounting*

1. Business Machines: Their Use in Modern Accounting Methods	New York University
2. An Analysis of the Adaptability of Different Types of Calculating Machines to Specific Business Computations*	University of Chicago
3. The Application of Machines to Modern Bank Accounting*	University of Chicago
4. The Use of Machines in Cost Accounting	University of Texas
5. Mechanical Devices in Cost Accounting with Special Emphasis on Auditing Features*	New York University
6. Mechanical Appliances in Cost Accounting for a Typewriting Manufacturing Plant*	Syracuse University
7. The Use of Modern Machines in Department Store Accounting	University of Illinois
8. Mechanical Accounting for Post Exchange	New York University
9. The Application of the Punched-Card Method in Accounting	University of Chicago
10. Punched Card Accounting*	Northwestern University
11. The Development of Machine Records	Washington University
12. A Uniform System of Machine Accounting for the State Teachers College of Texas	University of Texas

S. *Mergers, Consolidations and Holding Companies*

1. Major Accounting Problems in Corporate Affiliation	Boston University
2. Accounting for Mergers, Consolidations, and Holding Companies	University of Kansas

3. Public Utility Holding Company	New York University
4. Methods of Consolidating Statements	New York University
5. Problems in Accounting for Consolidated Surplus*	University of Missouri

T. *Price Levels*

1. A Consideration of Accounting Methods Under Stabilized Lower Price Level	University of Minnesota
2. A Plan for Reflecting Current Prices in the Ledger	University of Illinois
3. Accounting for the Re-adjustment of Fixed Asset Values Under Shifting Price Levels (1933)	University of Denver
4. Accounting During Inflation*	University of California
5. Accounting Principles and Practice Which Tend for Varying Dollar Values*	Northwestern University

U. *Statistical and Financial Analyses—Graphic Methods*

1. An Accounting Analysis of Chrysler Corporation	College of the City of New York
2. An Accounting and Statistical and Interpretation of the Coco-Cola Company—1922–'31	College of the City of New York
3. Statistical and Accounting Analysis of Coty, Inc.	College of the City of New York
4. An Accounting and Statistical Analysis of the Cudahy Packing Co.—1923–'31	College of the City of New York
5. An Analysis of the Statements and Financial Study of Dodge Brothers, Inc. and Chrysler Corporation	College of the City of New York
6. An Accounting and Statistical Analysis of the Fox Film Company	College of the City of New York
7. An Accounting Analysis of the General American Tank Car Corporation—1922–'31	College of the City of New York
8. An Accounting and Statistical Analysis of the Hupp Motor Car Corporation	College of the City of New York
9. An Accounting and Statistical Analysis of Sears, Roebuck and Company—1921–'31	College of the City of New York
10. An Accounting and Statistical Analysis and Interpretation of the Union Carbide and Carbon Corporation for the 10 Year Period Ending December 31, 1931	College of the City of New York
11. Methods of Analyzing Financial Statements of Chain Store Corporations*	University of Chicago
12. Ratio and Statement Analysis of Texas Retail Drug Stores for 1929	University of Texas
13. A Study of the Financing and Operating Results of the Larger Packing Companies*	University of Chicago
14. A Study of the Accuracy of Certain Forecasts of Pig Iron Production	Northwestern University
15. Working Capital Policies in Steel Industry	New York University
16. A Study of Operating Ratios of American Railroads	University of Chicago
17. The Progress of Industry in the South	University of Alabama
18. Analysis of a Winery*	New York University
19. A Study of Plant and Capital Turnover Ratios	University of Minnesota
20. A Study of the Changes in Working Capital Position Caused by Seasonal Variations in Sales	Northwestern University
21. A Study of Financial Statements with a View to Enlightening Prospective Investors*	Northwestern University
22. Detecting Tendencies Towards Failure Through an Analysis of Statements	New York University
23. The Effect of the Business Cycle on Certain Financial and Operating Ratios	Columbia University
24. Interpretative Accounting	University of Illinois

25. Managerial Statements and Statistical Data as an Aid in Control	Syracuse University
26. Developments in the Analysis of Financial Statements	Boston University
27. A Study of Methods of Analyzing Operating Statements	Ohio State University
28. A Critique of the Fixed Charges Times Earned Ratio	Columbia University
29. A Study of Current and Allied Ratios in Various Industries	Columbia University
30. The Statement of Application of Funds	Louisiana State University
31. The Statement of Application of Funds and Statements Accounting for Variations in Net Profit	University of Texas
32. Graphic Methods*	New York University

V. *Special Accounting Problems of Specific Enterprises*

1. A System of Perpetual Inventory and Operating Record of Underground Cables and Pipes Supplying Urban Territories with Electric Current	College of the City of New York
2. Inventory Control for Chain Stores (classification "I" also)	College of the City of New York
3. Design and Installation of a Labor Control and Payroll System for the Century of Progress*	University of Chicago
4. Economic Problems of Coal Mining in the United States with a Special Treatise on Uniform Accounting Practice	Boston University
5. Accounting for a Connecticut Tax Collector	New York University
6. Some Accounting Problems of Department Stores	University of Illinois
7. Accounting Problems of Nebraska Hospitals	University of Nebraska
8. Specific Aspects of Accounting as Applied to a Retail Furniture Establishment	Boston University
9. The Accounting Problems of the Investment Trust	University of Illinois
10. Some Accounting Methods Peculiar to Motion Picture Producers and Distributors	Boston University
11. Accounting Methods and Fiscal Reports of a Navy Purchasing Office	New York University
12. Some Administrative and Accounting Problems of the Publication Department	University of Chicago
13. Some Accounting Aspects of the Regulation of Public Utility Rates	University of Missouri
14. Depreciation of Public Utility Properties	Washington University
15. A Study of the Depreciation Policy of Public Utilities*	Northwestern University
16. Student Credit Hour Costs in Normal Schools* (classification "N" also)	University of Minnesota
17. Accounting and Financial Control for High-School Extra-Curricular Activities	University of Texas
18. Accounting Systems and Routines for Handling Transactions in Connection with Employees Stock Purchase Plans	New York University
19. Telephone Plant Accounting	New York University
20. Accounting for Telephone Revenues*	Northwestern University
21. Measuring Potential Vehicular Traffic Demand in the Port of N. Y. Authority for the Purpose of Planning Toll Crossings	New York University
22. Purchasing and Stores Control for Universities (classification "I" also)	Washington University

W. *Theory and Practice*

1. Branch House Accounting	Louisiana State University
2. Theory of Capital Accounting	University of California
3. Conservatism and Expediency in Accounting Practice	University of Illinois
4. Defects in Organization and Accounting Procedure Which Permits or Facilitates Fraud	University of Illinois

5. Foreign Exchange Accounting	University of Texas
6 Theory and Problems of Foreign Exchange as Applied to Accounting*	Northwestern University
7. Some Problems Arising in the Determination of Corporate Income and Its Disposition	Columbia University
8. The Changing Concept of Net Income	University of Missouri
9. Accounting for Instalment Sales	University of Texas
10. The Instalment Sale in Modern Merchandising the Accounting Viewpoint	Columbia University
11. N.R.A. Accounting Development*	Washington University
12. A Survey in the Objectives of Accountancy	University of Illinois
13. Payroll Accounting	New York University
14. Importance of Accountants Reports	New York University
15. Accounting for Sales	Columbia University
16. Stock Dividends and Stock Rights as Income to the Recipient*	Northwestern University
17. Stock Dividends as Income	Louisiana State University
18. Accounting for the Receipt of Stock Dividends	University of Illinois
19. Accounting in the U.S.S.R.	University of California
20. Accounting Treatment of Fixed Assets in the Unregulated Industries*	Boston University
21. What an Accountant as a Business Counsellor Should Know About Fire Insurance	University of Texas
22. Legislation for the Practice of Public Accounting in the United States	University of Chicago
23. Problems in Accounting for Owners' Equity (classification "J" also)	Boston University
24. Investment Problems in Public Accounting	College of the City of New York
25. Managerial Profits*	Northwestern University
26. Efforts Toward Standardizing Accounting Practices*	Boston University
27. Relation Between Paciolo and Later Writers*	University of California
28. German Explanation of the Fundamentals of Double Entry Bookkeeping Theory	University of Illinois

X. *Miscellaneous—*

Professional Societies, Balance Sheet Items, Interest as a Cost, Voucher System, etc.

1. An Evaluation of the American Institute of Accountants and the American Society of Certified Public Accountants*	University of Chicago
2. The Purposes and Accomplishments of Professional Accounting Organizations	University of Illinois
3. Accrued and Deferred Items	University of Illinois
4. Bonds, Bond Amortization, and Sinking Fund	College of the City of New York
5. Funds and Reserves	New York University
6. Accounting for Sinking Funds	Boston University
7. Reserves and Funds	New York University
8. Viewpoints of Authorities on Reserves and Funds	New York University
9. Some Accounting Principles for Reserve Funds	New York University
10. Viewpoints of Various Authorities on Reserves and Funds	New York University
11. The Voucher System*	Louisiana State University
12. The Voucher System	College of the City of New York
13. Accounting Payable Voucher System—Theory and Practice	University of Pennsylvania
14. Interest as Related to Cost*	University of California
15. Interest as an Element of Cost*	Columbia University
16. Accounting as Field for Colored Men	University of Pennsylvania
17. Interest and Discount on the Books of Account	College of the City of New York
18. Cash and Trade Discounts	Louisiana State University
19. A System of Internal Check	Columbia University

Y. *Not Classified*

1.	Capital Stock as a Trust Fund	University of Illinois
2.	The Organization and Management Methods of Chambers of Commerce	University of Chicago
3.	Evaluation of Economies in a Large Multi-Product Manufacturing Plant	Northwestern University
4.	Aviation Finance	New York University
5.	Financing of Homes in New York City	New York University
6.	Financing Methods in Philanthropic Organizations*	Boston University
7.	Method of Financing a Subsidiary	New York University
8.	A Study of Liberty Bond Price Movements	New York University
9.	Fiscal Administration of Kansas Institutions	University of Kansas
10.	Going Value in Public Utility Rate Cases*	University of Chicago
11.	N.R.A.—Retail Codes	New York University
12.	Legal Phases of Trade Associations*	New York University

SOME PROPOSED CHANGES IN DEPARTMENT STORE ACCOUNTING PROCEDURE

MALCOLM P. MCNAIR

DURING THE past eighteen months two proposed changes in department store accounting procedure have attracted the attention of controllers and other executives in large-scale retail enterprises. Both these proposals originated with Carlos B. Clark, Controller of the J. L. Hudson Company in Detroit. By reason of his long service and noteworthy contributions to the field of department store accounting, Clark is virtually the dean of department store controllers. His suggested innovations in the usual retail accounting procedure have therefore been widely discussed.

The first of these proposed changes is the so-called Clark Plan of altering the traditional form of the retail profit and loss statement in such a way as vitally to modify the concept of gross profit, or gross margin. Commonly department stores have followed customary procedure in determining a figure for the difference between net sales and the cost of goods sold. Formerly this difference received the usual designation of "gross profit"; in recent years department store executives, in common with many other retail merchants, have increasingly used the term "gross margin" to describe this same figure. This gross margin figure ordinarily has included cash discounts received on merchandise; likewise this figure has reflected any losses from inventory depreciation. In accordance with traditional usage, the cost of transportation on incoming merchandise has been included in the cost of purchases, and has not been part of the expense deducted from gross margin in order to arrive at net profit. Quite generally in department stores the net alteration costs on ready-to-wear garments and clothing have similarly been considered as part of the cost of merchandise. Occasionally, also, some other items of outlay in connection with incoming merchandise, such as insurance and customs duties, have been included in the cost of goods. From this gross profit or gross margin figure has been subtracted the total cost of doing business to arrive at the final net profit. This conventional treatment is shown in Table 1, which presents common figures for one of the groups of department stores reporting to the Harvard Bureau of Business Research for the year 1933.

For a long period of years the cost of doing business has been on the increase in department stores. As far back as 1920, department store expenses were not above 26% of sales. By 1932, department store expenses had risen to 39.5% of sales. This very great increase in the cost of doing business in department stores has been accompanied by a corresponding increase in the gross margin. By 1933 the typical gross margin of department stores had reached a figure of 36% of sales; that is, the department stores in 1933 were taking 36 cents out of each consumer dollar spent over the counter, in an effort to cover the cost of doing business; and yet in that year 36% of net sales did not cover all the costs, including interest on investment. Nevertheless, stores are sensitive about facing criticism by consumers of this wide spread between costs and selling prices. This sensitiveness about the gross margin percentage is not a new thing. In 1920 there was similar criticism, and department stores were similarly perturbed; and out of that situation grew the use of the term "gross margin" to replace the older term "gross profit." But no matter what this spread is called, it has been widening; and stores have been worried about this fact.

Clark therefore has proposed that on the profit and loss statement the merchandise spread, or gross margin, should be narrowed by assigning certain expense items to cost of merchandise. A form of the Clark Plan which was approved by the National Retail Dry Goods Association is shown in Table 2, with rearranged common figures for the same

TABLE 1

TRADITIONAL ARRANGEMENT OF THE OPERATING STATEMENT ILLUSTRATED WITH COMMON FIGURES FOR DEPARTMENT STORES WITH NET SALES OF FROM $4,000,000 TO $10,000,000*

(Dollar Figures in Thousands)

GROSS SALES	$6,132		
Less Returns	632		
NET SALES		$5,500	100.0%
Inventory—Beginning of Period	$770		14.0%
Net Purchases of Merchandise	3,668		66.7
Inward Freight, Express, and Truckage	55		1.0
Gross Cost of Merchandise Handled	$4,493		81.7%
Inventory—End of Period	825		15.0
Gross Cost of Merchandise Sold	$3,668		66.7%
Cash Discounts Received	192		3.5
Net Cost of Merchandise Sold	$3,476		63.2%
Alteration and Workroom Costs	44		0.8
Total Merchandise Costs (Net)		$3,520	64.0%
GROSS MARGIN		1,980	36.0
TOTAL EXPENSE BY FUNCTIONS			
Administrative and General			
Accounting Office, Accounts Receivable, and Credit	$160		2.9%
Executive and Other Administrative and General	263		4.8
Total Administrative and General	$423		7.7%
Occupancy			
Operating and Housekeeping	$ 96		1.75%
Real Estate Costs	313		5.7
Fixtures and Equipment Costs	72		1.3
Heat, Light, and Power	47		0.85
Total Occupancy	$528		9.6%
Publicity			
Sales Promotion and General Advertising	$291		5.3%
Display	28		0.5
Total Publicity	$319		5.8%
Buying and Merchandising	259		4.7
Direct and General Selling	501		9.1
Delivery	82		1.5
TOTAL EXPENSE		$2,112	38.4%
NET PROFIT OR LOSS		L.$ 132	L. 2.4%
Net Other Income (Including interest on capital owned)		236	4.3
NET GAIN		$104	1.9%

* Figures reproduced from Harvard Business School, Bureau of Business Research, Bulletin No. 92, *Operating Results of Department and Specialty Stores in 1933*, Table 9, page 14, and Table 19, page 28.

group of stores as shown in Table 1. Under this form of the plan there are added to purchases the transportation costs and the workroom (i.e., alteration) costs to arrive at a *total market cost*. After deduction of cash discounts to arrive at *net market cost* there are added all buying, receiving, and marking costs, that is, all the costs involved in ob-

TABLE 2

NEW ARRANGEMENT OF THE OPERATING STATEMENT APPROVED BY THE NATIONAL RETAIL DRY GOODS ASSOCIATION ILLUSTRATED WITH COMMON FIGURES FOR DEPARTMENT STORES WITH NET SALES OF FROM $4,000,000 TO $10,000,000*

(Dollar Figures in Thousands)

SALES	$6,132		
Less Returns	632		
NET SALES		$5,500	100.0%
Retail Reductions:			
Mark-downs	$385		7.0%
Shortages	74		1.35
Discounts	30		0.55
Original Retail of Sales	$5,989		108.9%
MERCHANDISE			
Inventory—First of Period	$770		14.0%
Purchases	3,668		66.7
	$4,438		80.7%
Inventory—End of Period	825		15.0
	$3,613		65.7%
Transportation	55		1.0
Workroom	44		0.8
TOTAL MARKET COST	$3,712		67.5%
Cash Discount	192		3.5
NET MARKET COST	$3,520		64.0%
All Buying-Receiving-Marking	259		4.7
Total Occupancy	528		9.6
TOTAL COUNTER COST		4,307	78.3%
MERCHANDISE SPREAD		$1,193	21.7%
EXPENSE			
Selling	$ 501		9.1%
Delivery	82		1.5
Administrative	423		7.7
Publicity	319		5.8
TOTAL EXPENSE		1,325	24.1%
MERCHANDISE PROFIT OR LOSS		L. $132	L. 2.4%
Net Other Income		236	4.3
NET GAIN		104	1.9

* Figures reproduced from Harvard Business School, Bureau of Business Research, Bulletin No. 92, *Operating Results of Department and Specialty Stores in 1933*, Table 9, page 14.

taining merchandise, getting it into the store, and making it ready for sale. Also at this point are to be added the total occupancy costs, that is, the rent, light, heat, janitor and housekeeping service, and similar expenses. The sum total of the cost of merchandise, transportation costs, alteration workroom costs, buying, receiving, and marketing costs, and occupancy costs is to constitute the so-called *total counter cost*. The difference between this net cost and net sales is the new gross margin, or *merchandise spread*, figure. On the basis of the Harvard Bureau's figures for a typical group of department stores in 1933, as shown in Table II, the gross margin figure would thus be re-

TABLE 3

NEW ARRANGEMENT OF THE OPERATING STATEMENT ADVOCATED BY MR. C. B. CLARK ILLUSTRATED WITH COMMON FIGURES FOR DEPARTMENT STORES WITH NET SALES OF FROM $4,000,000 TO $10,000,000*

(Dollar Figures in Thousands)

SALES		$6,132		
Less Returns		632		
NET SALES			$5,500	100.0%
Retail Reductions:				
Mark-downs		$385		7.0%
Shortages		74		1.35
Employees Discount		30		0.55
Original Retail of Sales		$5,989		108.9%
MERCHANDISE				
Inventory—First of Period		$770		14.0%
Purchases	$3,723		67.7	
Less Cash Discounts	192	3,531	3.5	64.2
Work rooms		$ 44		0.8
Direct Buying, Receiving and Marking		192		3.5
Direct Selling		407		7.4
Direct Selling Delivery		83		1.5
		$5,027		91.4%
Inventory—End of Period		825		15.0
DELIVERED COST OF SALES			4,202	76.4%
MERCHANDISE SPREAD			$1,298	23.6%
DEPARTMENT EXPENSE				
Administrative		$55		1.0%
Occupancy		11		0.2
Publicity		275		5.0
			341	6.2%
DEPARTMENT CONTRIBUTION			$957	17.4%
INESCAPABLE EXPENSE (General Store)				
Administrative		$368		6.7%
Occupancy—Sundries; Space Chg.; Warehouse		517		9.4
Publicity		44		0.8
Buying		66		1.2
Selling		94		1.7
			1,089	19.8%
NET MERCHANDISE PROFIT OR LOSS			L. $132	L. 2.4%
Net Other Income			236	4.3
NET GAIN			104	1.9

* Figures reproduced from Harvard Business School, Bureau of Business Research, Bulletin No. 92, *Operating Results of Department and Specialty Stores in 1933*, Table 9, page 14.

duced from 36% of sales to 21.7% of sales. The remaining expenses, not assigned to cost of merchandise, including selling expense, delivery expense, publicity expense, and administrative expense, would then constitute the so-called *total expense*. For this same group of stores in 1933 these items aggregated 24.1% of sales, in comparison with the typical total expense figure of 38.4% determined in the traditional manner. The net

profit or loss figure, of course, is not in any way affected by the proposed change.

After this proposed change had been approved by the National Retail Dry Goods Association, Clark himself advocated a somewhat different arrangement, as shown in Table 3, under which the items to be added to merchandise costs include alteration workroom expense, direct buying, receiving, and marking expense, direct selling expense, and direct delivery expense, thus arriving at a so-called *delivered cost of sales.* On this basis the *merchandise spread,* or gross margin, for the typical group of stories previously mentioned would be 23.6% of sales. From this is deducted, first of all, the direct *department expense,* including some administrative expense, a very small amount of occupancy expense (janitor service and so on), and most of the publicity expense; and secondarily there is deducted from the remainder, or *department contribution,* the *inescapable expense.*

The philosophy of this plan differs considerably from the proposal accepted by the National Retail Dry Goods Association. This revised Clark Plan adds to the cost of merchandise all the expenses that can be attributed directly to the buying, handling, selling, and delivery of the merchandise. It then deducts from the resulting *merchandise spread,* or gross margin, the indirect expenses that are connected with the maintenance of individual departments; that is, so far as any one department is concerned, the expense that would not be incurred if the department were dropped. These items, as shown in Table 3, for the particular group of stores previously cited, amounted to 6.2% for 1933, made up of publicity expense of 5%, administrative expense of 1%, and occupancy expense of about 2/10 of 1%; this figure subtracted from the merchandise spread of 23.6% leaves a *department contribution* of 17.4%. From this, however, is deducted the so-called *inescapable expense,* in which are included all the administrative expense, all but a small part of the occupancy expense, some selling expense, part of the buying expense, and a small part of the publicity expense. The criterion for throwing expenses into this group is to be the decision whether the particular expense item is a continuing expense not affected by the dropping of one or more departments. The total of this group of unavoidable expenses for the stores previously cited was 19.8% in 1933, leaving the typical loss of 2.4% characteristic of this group of stores. (It should be mentioned parenthetically that these expense figures include interest on investment. The net gain, or net profit in the more usual business sense, for this group of stores was 1.9%.)

Both these versions of the Clark Plan have in common the idea of reducing the gross margin by adding certain items to the cost of the merchandise in the same way in which inward transportation and alteration workroom costs now customarily are added. Where the versions differ is in the reasoning as to which particular expenses should be assigned to cost of merchandise and which should be kept in expense.

The principal arguments advanced for this innovation in the retail profit and loss statement are three in number. First, it is contended, rather naïvely, that if department stores show a gross margin, or merchandise spread, of 22% or 23% of sales as compared with the present figure of about 36% of sales they will be subject to much less criticism from consumer spokesmen, politicians, and public administrators. It is clear that certain people in Washington were horrified at finding that the typical spread in department stores was in excess of 35% of sales; and the resulting clamor placed a great many retailers on the anxious seat.

It is further contended that such a change in the profit and loss statement would place retail accounting more nearly on a par with manufacturers' accounting. The manufacturer buys raw materials and processes them; he adds the labor and overhead costs of the manufacturing operations to the cost of the materials to arrive at a net manufactured cost, or factory door cost. Between this cost and the selling price the typical spread, or gross margin, for a manufacturer frequently is not more than 15% to 25% of sales. Out of this spread come the marketing expenses,

usually the general administrative expenses, and finally the manufacturer's profit. The advocates of the proposed changes in the department store profit and loss statement urge that the time and place utilities added to the merchandise by the retailer should be considered as being on all fours with the form utilities given to the raw materials by manufacturers, and should similarly appear in the profit and loss statement as additions to the cost of the merchandise rather than as expenses.

Finally it is argued that large-scale retail organizations such as department stores have, during the last 20 years, largely absorbed the wholesale function. These stores buy comparatively little from wholesalers; nor do they wait for manufacturers' salesmen to come to them. Most of their own buyers go directly to manufacturers in the market. It is pointed out that when the distributive functions are performed by a wholesaler, or by a manufacturer selling direct to retailers, the cost of the goods to the store includes a margin to cover the wholesaler's or manufacturer's distribution expense. When the store goes directly to the manufacturer in the market and buys at a lower cost, the distribution expense which it thus assumes in the form of buying, handling, and storage expense traditionally has not been considered a part of the merchandise cost but has been labelled "operating expense." Therefore, it is argued, the cost of doing business for such stores, and consequently their gross margin or spread, has been considerably increased because of this absorption of the wholesale function. The true situation would be better revealed, it is urged, by treating all these expenses incurred in the acquiring of merchandise as part of the merchandise cost.

One may well feel much sympathy for the position in which department stores find themselves. Their profits, even during periods of prosperity, have not been large; typically they have averaged well under 5% of sales, even for well-managed stores. During the depression their sales volume in dollars fell more than 40%, and the inability to reduce expenses correspondingly occasioned severe losses. Then with the rising prices which characterized the last half of 1933 and the first part of 1934 they found themselves subjected to ignorant and unfair criticism from certain sources. But there is no use trying to dodge the fact that the costs of doing business in department stores have increased very substantially. It is to be expected that normally in a period of depression and declining sales volume the expense ratio will rise. But taking 1921 as the bottom point of the post-war depression and 1932 as the bottom point of the great depression, the cost of doing business in department stores over this 11-year period increased more than 40%. The total expenses of 301 department stores reporting to the Harvard Bureau of Business Research for 1921 were 27.8% of net sales; for 501 firms reporting for 1932 the total expense was 39.5%—a difference of 11.7% of net sales, or a total increase of 42.1%.

In order to make a beginning at understanding this very sharp rise in the total expense ratio of department stores, the increase must be divided into two parts. Between 1921 and 1929 the total cost of doing business advanced from 27% or 28% of sales to about 33%; over the period from 1929 to 1932 the expense ratio advanced from 33% to about 39.5%. This latter part of the increase is easy to account for. The dollar volume of sales dropped over 40% because of the decline in prices. The physical volume of sales showed little if any decrease; almost the same number of items or yards or pieces of merchandise were being handled. Consequently it was extraordinarily difficult to reduce expenses. This was particularly true of fixed charges. In spite of unremitting efforts to achieve economies, a rise in the expense ratio from around 33% to nearly 40% was almost inevitable.

It is not so easy to account for the earlier part of the increase, during the great boom period of the 1920's, when one would normally expect to find the expense ratio decreasing. It is probable that part of this rise in the expense rate during the 1920's represents the cost of functions transferred from other sectors of the distributive system; but

even at the most liberal estimate it is unlikely that such transferred costs represent more than 2% of sales, or only a little more than one-third of the increase which took place between 1921 and 1929. Another part of the increase certainly must be attributed to what may be termed the rising standard of living. Customers have demanded more services. Competition has forced the offering of these services. For example, it is well established that returns of merchandise by consumers increased greatly during this period. Likewise fashion influences, together with a slowly declining price level, brought about a type of hand-to-mouth buying and merchandising operation which presumably was a factor of some importance in increasing the cost of doing business. Again, competition of other forms of retailing, notably chains, probably was one of the factors which caused the curve of department store sales to flatten out after 1925, with a resulting adverse effect on the expense rate. But all this reasoning is more or less in the realm of surmise. All that we know for certain is that the expense rate in department stores increased substantially during the prosperous period of the 1920's and that with the great price decline in the depression there ensued another sharp rise in the cost of doing business, with the result that some department stores are now casting about for some method of making it appear that they are not taking so much out of the consumer's dollar.

Taking up the three arguments for the Clark Plan, we may recognize the validity of the contention that some part of the increase in the cost of doing business in department stores is probably attributable to the cost of functions transferred from other sectors of the distributive system. It would be most important to verify this hypothesis by studying the distribution costs of manufacturers of goods sold almost exclusively to department stores; such a vertical type of distribution cost study is greatly needed. But it seems unlikely that such a transfer of costs at the outside can represent more than 2% or 3% of sales, and therefore the argument in favor of the Clark Plan can scarcely be based on this contention alone.

Next, the presumed analogy between the manufacturer's profit and loss statement and the department store profit and loss statement is rather far-fetched. If one takes the broad view of economic theory, it is true that the distinction between the form utilities created by manufacturers and the time and place utilities created by the distribution system is of relatively little moment; but from the standpoint of actual accounting procedures for different businesses there is every reason for making a sharp distinction. The manufacture of goods is highly specialized, as contrasted with the distribution of goods; thus a factory may and frequently does make one or a few products, whereas the retailer carries a very large number of types of goods. It follows that the processing costs in the factory can be attached fairly directly to individual goods, but in the retailer's establishment it is not possible to attach any large part of the costs to particular goods. This difference alone is sufficient to justify the different accounting procedures which have developed as between manufacturers and retailers.

Furthermore, it is pertinent to inquire whether the changes which have been proposed contribute anything to managerial efficiency. Is the control of a department store's operations in any way facilitated by a form of retail accounting in which part of the expenses are thought of as successive costs added to the merchandise and another part of the expenses are thought of as the general expense of doing business? This line of thought immediately raised the question whether the sponsors of these innovations expect to have their proposed changes adopted as part of the internal accounting procedure in the various departments, or whether they merely desire to have the final profit and loss statement drawn up on the new basis without alteration of existing procedures in the stores. Both Clark and other retail store executives who have advocated these changes have not been wholly clear on this point. It is rather difficult to visualize how control of operations in a department store would be facilitated if department heads and buyers, instead of

thinking about their merchandising operations in terms of a spread between cost of purchases and selling price sufficient to cover all expenses, were to be re-educated to think in terms of successive costs added to the cost of the goods until a certain point was reached. For one thing, such a step probably would mean abandoning the system of retail percentages which has so long been in vogue in department stores. It is already sufficiently hard for buyers to keep their thinking straight in dealing with a single merchandise spread; it is very difficult to see what gain in efficiency would result if that spread were to be broken down into smaller segments, as proposed. The buyer would still have to buy merchandise from the manufacturer at a first cost which would permit him to sell it to the consumer at a final retail price allowing a sufficient spread to cover all the costs of doing business, no matter whether these were considered as merchandise costs or as genuine operating expenses. It appears, therefore, that we can dismiss the argument that any gain in efficiency would result from the proposed changes in retail accounting if they were carried down through the internal accounting procedures for the various selling departments.

There remains finally the contention that a mere change in the form of the profit-and-loss statement such as proposed would present the department stores' case more effectively before the bar of public opinion. This argument also is a little difficult to grasp. In the first place, department stores do not publish any detailed profit and loss statements. Such statements as are published ordinarily lump the cost of merchandise and the total expense of doing business into one figure, which when subtracted from the net sales shows the net profit.[1] Furthermore, whenever investigators representing governmental or semi-governmental agencies undertake to ascertain any facts about the relative costs of the retail function and the relative efficiency with which the function is performed, they ordinarily proceed by comparing recorded selling prices of specific articles of merchandise with actual invoices of those goods as sold by manufacturers to the stores. It seems obvious that if department stores were generally to adopt the practice of putting their profit and loss statements into the form proposed by Clark they would become the immediate target of redoubled criticism from the business reformers on the score that they were trying to conceal something nefarious. This argument from the angle of public relations is a boomerang.

In this proposal to alter the traditional retail profit and loss statement we have a clear instance of the effect on accounting exerted by the experience through which department stores have gone since the beginning of the depression. The decline of 40% or more in sales volume and the inability to adjust expenses (particularly fixed charges) to the lower price levels have forced department stores to seek higher gross margins. At the same time that they have sought to increase mark-up, stores have become increasingly conscious of a possible public reaction to such wide merchandise spreads. Hence they seek some device that will put a better face on the matter. But the Clark Plan is not the answer.

Similarly the effect of department store experience since the depression may be observed in a second proposal affecting department store accounting, which also emanates from Clark. This proposal concerns the relation of individual selling departments to the business as a whole from an accounting standpoint. It is the old problem of allocation of indirect expenses. In his so-called "Reservoir-Department Contribution" concept Clark proposes that the existing allocation of indirect expenses to selling departments in department stores should be discontinued in favor of a plan by which an individual selling department would be judged by its contribution to the cash drawer, or reservoir, out of which is paid the cost of general services and fixed charges. Each department's so-called *contribution* is to be the gross margin of that department

[1] The recently issued regulations of the Securities and Exchange Commission apparently require that data be shown in company reports which will permit the computation of gross margin.

less the direct expenses of that department. To quote from a description of this plan which appeared in the *Retail Ledger* for December, 1933:

. . . It becomes increasingly apparent that a department store cannot be managed on the theory of a group of parallel departments, each contributing its residuum of net profit or loss to the exchequer. Instead, it must be pictured by management as two distinct activities and judged each by its own set of measurements. The selling departments are not parallel businesses producing net profit, but are like streams pouring each its contribution into a common reservoir. That contribution consists of the gross margin on its sales, less its direct expenses. What are its *direct* expenses? They are those expenses which would not exist if the department were discontinued, and therefore are almost directly controlled in relation to that department alone.

Out of that common reservoir flow the penstocks feeding the store-wide service activities of the store and meeting the fixed charges. Net profit is whatever is left in the reservoir. So net profit can be built up either by increasing the flow into the reservoir or decreasing the outflow. Anything extra that increases the number of dollars flowing in without requiring more outflow increases the size of the profit residue that will be there at the end of the year.[2]

This proposal is rather closely related to Clark's other proposal, in regard to the form of the operating statement, since the final form of his suggested change in the operating statement, as shown in Table 3, involves adding most of the direct expense to the cost of the merchandise, subtracting from the merchandise spread the other items that can quite accurately be allocated to departments (the *escapable* items), and calling the remainder the department *contribution;* from the total of the *contributions* from all departments, *inescapable,* or general store, expense is subtracted to arrive at the final net profit or loss.

In order to appraise this proposal it is necessary to go back a number of years and consider briefly some aspects of the history of expense allocation in department stores. On the whole, department stores in the past have used rather sloppy methods of prorating or allocating indirect expenses to selling departments. Formerly, for instance, in many stores net sales were used as the basis for prorating a large number of indirect expenses, even including, in some cases, rent expense. Receiving and marking expenses frequently were prorated on the basis of the average cost of purchases. Accounting office and credit office expenses both were charged on the basis of sales; some stores did not even bother to allocate credit office expense on the basis of charge sales, but rather prorated it on the basis of total net sales. Where a square foot basis was used for charging rent, it was the common practice not to charge rent to any non-selling departments. The usual large department store has only about two-thirds of its space occupied by selling departments; the rest of the space is utilized by offices, stock rooms, delivery, receiving and marking, and other non-selling functions. Ordinarily all the rent cost was lumped on the selling space, with the result that rent was not shown as a part of office expense, receiving expense, delivery expense, and so on.

A further complicating factor was introduced by the desire of many department stores to exchange figures reflecting departmental performance. Such associations as the Retail Research Association and the Speciality Stores Association, as well as some of the department store ownership groups, have for a number of years exchanged such departmental figures monthly. Naturally such an exchange of departmental figures presupposes uniform bases of allocation of indirect expense to departments. Whenever such groups got together to work out uniform bases of allocation, so much difficulty was encountered in reconciling different methods of procedure developed in the different stores that recourse usually was had to a few rather simple bases of allocation. The consequence, of course, was that the resulting departmental figures for net profit and loss were far from reliable. Nevertheless it appears to be a fair statement that many department store managements probably

[2] Clark, Carlos B., "'Reservoir Concept' Is Keynote of Future Profits," *Retail Ledger*, December, 1933, p. 13. Quoted by permission.

paid too much attention to these departmental profit and loss figures; and decisions with respect to dropping, adding, curtailing, or expanding departments in some instances probably were made unwisely on the basis of such figures. Because of these sloppy methods of allocation, department managers frequently became disgruntled and sought to have the management change the bases of allocation. Where such steps were taken, there are instances on record of sharp reversals in the profit and loss showing of departments purely because of changes in the bases of prorating indirect expenses.

In the latter part of the 1920's this unsatisfactory situation with respect to methods of expense allocation in departments caused the Controllers' Congress of the National Retail Dry Goods Association to appoint a committee on expense allocation. The Controllers' Congress, it should be remarked, previously had done a very important and significant piece of work in the development of the Expense Manual, a standard classification of accounts for department stores. With respect to methods of expense allocation, however, so much difference of opinion developed in the committee that the job was, to all intents and purposes, shelved for the time being. Later the local group of department store controllers in New York City, the Metropolitan Controllers' Association, drawing considerably on the work of the earlier committee, developed the Expense Distribution Manual. The bases of distribution for indirect expenses provided in this Manual are as shown in Chart 1. There are perhaps minor points on which one might differ with respect to some of these suggested bases, but in general this Manual represents a substantial advance over the methods of expense allocation previously in use in a majority of department stores.

It should also be pointed out that this Expense Distribution Manual provides for some distribution of expenses between subfunctions. The principal subfunction involved is the fixed plant and equipment, or real estate, cost; here it is recognized that there is as much reason for charging the office and the marking room with rental costs as there

Chart I

Expense Distribution Chart*

Functional Classification	*Basis of Distribution*
Administrative	
Executive Office	Sales
Accounting Office	
Auditing	Number of Transactions
Accounts Payable	Number of Invoices & Returns
Statistical	Part Direct; Balance Equal for Each Department
Cashier, Salary and General Office	Sales
Accounts Receivable & Credit Office	
Accounts Receivable	Number of Charge Transactions
Credit Office	Charge Sales
Superintendency	
Mail & Telephone Order	Number of Orders
Merchandise Adjustment Office	Number of Adjustments
Training, Welfare, and Other Superintendency	Average Weekly Number of Employees on a Clerk Day Basis
General Store	
Interest on Merchandise	Average Cost Stock (6% per annum)
Insurance on Merchandise	Average Cost Stock
Other General Store	Sales
Occupancy	
Operating & Housekeeping	
Repairs	Direct
Other Expenses	Area Occupied
Fixed Plant & Equipment Cost	
Land, Building & Building Equipment Charges	Space Valuation
Fixture & Equipment Charges	Fixture Valuation
Light, Heat & Power	Area Occupied
Publicity	
Sales Promotion Office	Sales
Newspaper & General Advertising	
Direct Advertising	Direct
Institutional Advertising	Sales
Direct Mail	
Advertising, Supplies & Postage	Direct
Mailing Lists & Other Unclassified	Sales
Display	
Windows	Direct

* Metropolitan Controllers' Ass'n of New York, *Expense Distribution Manual* (New York, Controllers' Congress of the National Retail Dry Goods Association, 1932) pp. 11–12. Reproduced by permission

Signs	Direct
Interior Display & Institutional Windows	Sales
Buying	
Merchandise Management	
Merchandise Managers & Assistants	Group Sales
Buyers, Assistants & Clericals	Direct
Merchandise Control	Clerk Hours
Direct Buying Expenses	Direct
Other Buying Expenses	Sales
Domestic & Foreign Buying Offices	Purchases
Receiving & Marking	
Receiving	Number of Invoices & Returns) (Weighted)
Marking Supplies	Direct
Marking Expense	Markers' Hours
Selling	
Compensation of Salespersons	Direct
General Selling	
Floor Managers & Assistants	Average Weekly Number of Employees on a Clerk Day Basis
Stock & Clericals	Direct
Wrapping & packing (Including Supplies)	Per Package Cost
Salespersons Supplies	Direct
Miscellaneous Selling Expense	Sales
Delivery	Weighted Schedule

is for charging selling departments. The fact that the expenses of non-selling departments are themselves distributed to selling departments is not felt to be an adequate reason for refraining from distributing such an expense as rent among the non-selling departments in the first instance, as well as among the selling departments. It is easy to see, however, that reasoning which is sound in the case of rent might well be extended to other distributions of expense between subfunctions which might not be sound. For instance, the chief executives of the store must give some of their attention to the functioning of the non-selling departments, as well as to the operation of the selling departments. Is it reasonable to consider that some part of the executives' salaries and some of the expense of the executive offices should be distributed to the delivery department, for example, or to the warehouses, or to the credit office, and then redistributed to departments as part of those non-selling expenses? Clearly, one might pursue this matter of expense distribution between subfunctions too far. From a practical standpoint, rent and the allied real estate costs are very nearly the only items where a distribution of expense to non-selling departments is justified as a prior step to the distribution of all indirect expenses to selling departments.

In its introduction to the Expense Distribution Manual the Metropolitan Controllers' Association makes certain statements which are significant. To quote—

> The questions of departmental comparison between stores, and the distribution of expense as a means of expense control, were considered as secondary to the problem of "cost finding." The varying conditions in different stores would necessitate so many adjustments that at best an expense comparison by departments could only reveal those departments grossly out of line. The committee did not primarily propose, therefore, the writing of a manual specifically to facilitate accurate departmental expense comparisons between stores.
>
> The question of expense control as related to distribution of expenses was likewise considered secondary, although there are some things to be said for it. It is granted that to control expense, action must be taken before the expenses are incurred rather than after they are distributed. The point remains, however, that if the executives connected with the merchandising operations realize they are to be charged with expenses in the degree to which they are responsible for incurring them, more general interest will be manifest in the problem of expense control. It is believed that this will be accomplished if expenses are distributed with the prime object being that of "internal cost finding." In order to accomplish this purpose the committee proceeded on the following general principles:
>
> 1. That all items of expense should be charged as far as possible, directly to their originating departments—selling or non-selling. The only exceptions should be items small in amount and chargeable to two or more departments. Although direct, they may be treated as indirect to avoid useless clerical cost in making direct charges.
>
> 2. That all items of expense not charged directly should be studied carefully in the light

of conditions prevailing in the individual store; that is, they should be studied to determine how each item affects individual departments. For example: An item ordinarily indirect may be incurred for all departments on a substantially equal basis and, therefore, it should be distributed on that basis. Another item may be incurred for only a small group; therefore, it should be distributed only to that group. Or an item may be incurred for all departments, but for some far more than for others; therefore, it should be distributed on a weighted basis.

The theory behind such a study involves almost direct charging in some instances, or at least semi-direct to insure that each department shall bear, as far as possible, all expense which is justly chargeable.

3. That the basis of distribution selected be best suited to bring out true costs.

   For manual purposes it was necessary to select bases which would apply in most cases. They should be used as guides in light of the varying conditions existing in different stores, and should be changed whenever conditions in the individual store make it evident that the bases do not result in just distribution.

4. That the distribution of indirect expenses be made not more often than semi-annually. Direct expenses, however, should be reported monthly and in some cases, such as Selling Salaries and Advertising, should be reported weekly.

   By eliminating monthly or quarterly distribution of indirect expenses, the increased cost involved in the more detailed distribution will be offset.[3]

This Expense Distribution Manual was adopted by the National Retail Dry Goods Association in 1932. Before any appreciable number of stores had placed their departmental accounting on this basis, the Clark "department contribution" concept, looking to the elimination of the departmental profit and loss figure and the substitution therefor of departmental *contributions* to a general fund to meet overhead expense and provide profit, became the subject of wide discussion.

There are several things to be said about this second Clark proposal. In the first place, this idea that the selling departments in a store should not have their operations analyzed to the extent of getting down to a final net profit or loss figure but should be judged by their *contribution* to overhead and general expense is clearly an outgrowth of depression experience. In a sense it reflects the defeatism of stores which for several years have found it impossible to show any net profit in a large group of their departments. To put it strongly, it is an excuse for continuing to carry losing departments.

In the second place, this proposal must be recognized as a reaction from the crudity and looseness of methods of expense allocation in vogue in many department stores and from the excessive attention that probably has been accorded to many of the resulting departmental profit and loss figures. In a sense, Clark's proposal is both an indictment of slipshod methods of cost finding in department stores and even more strongly an indictment of the management procedure in department stores. Too many retail executives have tried to run their businesses wholly on a figure basis. Control mechanisms clearly have their place in a department store, but they must be subordinated to sound merchandising skill and imagination and to a firm grasp of economic principles. In part, the difficulties of the department store have developed from the very nature of the institution itself. In a large store, selling a tremendous variety of merchandise through from 50 to 200 separate selling departments, with an elaborate functional organization, executives must necessarily rely on figures to know what is going on; and it then becomes too easy to rely wholly on figures. When the figures are as poor as many of the departmental indirect expense and profit figures certainly have been in numerous department stores, such reliance on figures to furnish managerial guidance can only result badly. One of the bad results, for instance,

[3] Metropolitan Controllers' Ass'n of New York, *Expense Distribution Manual* (New York, Controllers' Congress of the National Retail Dry Goods Association, 1932), pp. 2–3. Quoted by permission of the Controllers' Congress.

unquestionably has been the effort to achieve too great a uniformity in mark-up. In fact, the rigid thinking of many department store executives with respect to departmental expenses and profits may well have been one of the causes of the sharp increase in gross margin.

It is certainly fair to say that the Clark plan of judging each department by its *contribution* is much more nearly in accord with economic principles. In deciding whether to add a department or drop a department the executives in a going retail enterprise consider the problem on the basis of receipts versus outlay: What aggregate increase in revenue can be expected from a new department, or what amount of revenue will be lost if a department is discontinued? On the other hand, what direct expenses are involved in the addition or dropping of a department? Naturally these considerations must take into account the long run as well as the short run. If the department needs expensive fixtures or additional space, the long-run calculations may be rather different from the short-run view. But essentially the process is one of balancing a possible increase or decrease in receipts against a possible increase or decrease in expense, that is, expense not in terms of cost accounting but expense in terms of actual outlay. This is the normal basis on which to make such a decision, and it is quite true that the Clark proposal closely accords with this basis.

Does it therefore follow that the "contribution" plan of departmental cost accounting should be generally accepted and the practice of allocating indirect expenses discarded? Not necessarily; Clark and other advocates of the "contribution" plan have confused two things which are, or ought to be, more or less separate. There is no doubt that problems of expansion or contraction of departments ought to be dealt with on the basis just outlined, with due regard for the influence of some departments on the sales of other departments; for in this respect something approaching a joint cost situation exists in a large retail establishment. But the problem of departmental administration for the purpose of obtaining the greatest efficiency, or control of expense, is quite a different one, and it is for this problem that the process of departmental cost finding is useful. The point immediately may be raised that the selling department in a department store is not a good unit of control for indirect expenses. Although the wages of sales force and salaries of executives directly connected with the department, the advertising expenditures, and some part of the supply expense are subject to more or less control in the individual selling department, it is clear that the control of such expenses as receiving and marking, delivery, credit office, and so on, ordinarily is not approached from the individual selling departments but rather is approached directly through the sections of the organization responsible for those nonselling functions; that is, the reduction of delivery expense is regarded as a job for the manager of the delivery division and not as a problem for the heads of the individual selling departments. If that view were granted in toto, there would appear little reason not to accept the "contribution" plan. But this is a short view. These indirect expenses are incurred for services rendered to the selling departments; and it is not conducive to sound management if the heads of those departments are not cognizant of the costs of the services performed for them. The purpose of assigning indirect expenses to departments is to make the department managers expense-conscious. Even though the first approach to the task of reducing a particular classification of indirect expense does not lie through the selling departments, it is nevertheless true that there are many things which an expense-conscious department manager can do to reduce, say, the expense of receiving and marking goods for his department, or the expense of handling his invoices. Therefore, departmental cost finding is of some value. Department stores should not lightly reject such a program of expense distribution as that offered by the Metropolitan Controllers' Association of New York.

If this view of the expense distribution process is taken, it is doubtful whether any monthly or quarterly proration of indirect expenses is necessary in most stores. Rather,

it appears that a semi-annual cost-finding study would serve the same purpose. A further corollary of this view of the nature of the departmental cost-finding function in a retail store is that too great attention must not be paid to the resulting departmental profit and loss figures; particularly it is inadvisable to base bonuses or other forms of additional compensation on such figures.

Monthly, of course, it is desirable to show for each department the sales, the mark-up, the mark-downs, the gross margin, and the direct expenses. The remaining department *contribution*, to use Clark's phrase, that is, the excess of the gross margin over direct expenses, for each department, or perhaps preferably for a group of departments, can then be compared with the indirect expense figure which the last departmental cost-finding study has revealed.

From an economic standpoint, Clark reasons correctly about the relation of an individual selling department to the store as a whole, and he is on firm ground in suggesting a line of thought which executives should follow in deciding whether to add or discontinue departments. But it is by no means the sole purpose of departmental cost finding to furnish data for the use of executives on the occasions when such decisions are necessary. The knowledge of conditions which executives can obtain from the departmental cost-finding process is useful at all times in promoting greater effectiveness of management, and the only danger lies in using the departmental net profit or loss figure as the sole criterion in deciding whether to add or discontinue a department. Clark's "contribution" plan is thus essentially a warning to management to keep its various problems logically separate.

On Clark's first proposal, in regard to the form of profit and loss statement, the verdict is an unqualified negative. On the second proposal, with reference to the relation between a selling department and the business as a whole, he has supplied a possible needed corrective to the thinking of management, but has not provided any useful innovation in accounting methods.

ACCOUNTING FOR CUSTOMER PURCHASES AS A SALES PROMOTIONAL DEVICE

RALPH CASSADY, JR.

WITHIN THE last few years there has come to the fore in merchandising a sales promotional device based upon available accounting records of which comparatively little has been written but one possessing tremendous potentialities. This device, known among practitioners and theorists alike as customer analysis and control, is " . . . an attempt on the part of large stores (through analysis of purchase records) to get acquainted with their customers, their needs and buying habits."[1] By means of an analysis of customer accounts, buying habits can be discovered. Through such information more intelligent direct-by-mail promotional campaigns are made possible. Customer analysis and control might be described as accounting for customer buying habits and the utilization of such assembled data. Customer control, in other words, turns the records of credit accounts to maximum advantage; makes possible the use of accounting information directly for promoting sales. The accountant thus has a twofold interest in this contrivance, first, in that he may be required to set up a practicable system, and, second, that the use of accounting information is the backbone of the whole plan.

The need for customer analysis has manifested itself in many ways during the last ten years. For example, as a result of extensive study, it has been discovered that the bulk of consumers are not store customers but are rather department customers; that the store clientele patronizes at most only a few of the many store departments. Table I indicates this tendency quite clearly.

TABLE I

PERCENTAGE OF CHARGE CUSTOMERS PATRONIZING 15 LEADING DEPARTMENTS OF 25 DEPARTMENT STORES IN DIFFERENT PARTS OF THE COUNTRY

Department	*Percentage*
1. Hosiery	53
2. Toilet Goods	46
3. Underwear	40
4. Silks	38
5. Men's Furnishings	38
6. House Furnishings	37
7. Dresses	35
8. Shoes	33
9. Millinery	27
10. Linens	24
11. Boys' Wear	17
12. Coats	16
13. Men's Clothing	11
14. Furniture	10
15. Girls' Wear	10

As a result of this condition not only are sales not as great as they might be but the success of ensemble merchandising is very definitely threatened as well. It is felt by many also that customer analysis and control is the one method by which advertising can be made more effective as the effort in many instances is aimed more directly at actual purchasers of a specific type of merchandise, waste circulation thus being reduced to a minimum. The social implications of such a situation are manifest.

What, specifically, does customer analysis and control attempt to do? The scheme in the broad sense, embraces at least half a dozen important functions. Although some of these functions cannot be included as control devices in the strictest sense of the term, each requires the recording or use of accounting information and each falls directly or indirectly under the general heading of sales promotional effort and may, thus, be legitimately incorporated in this discussion.

Probably the most important activity falling into the afore-mentioned category is that of new customer solicitation. That there are vast potentialities in such a plan there can

[1] Leigh, Ruth, "Customer Control," *Printers' Ink*, January 1, 1931, p. 100.

TABLE II
RESULTS OF NEW ACCOUNT SOLICITATION—RESPONSE AND COST[2]

Date	*List*	*Accounts Opened and Used*	*Per cent Opened and Used*	*Pieces in Series*	*Cost Per Series*	*Cost Per Account Opened*
1927–28	3642 (A)	434	11.91	3	$526	$1.21
	3021 (B)	226	7.48	3	445	1.96
1929–30	5394	900	16.6	2	900	1.00
1930–31	6423	1045	16.3	3	965	.92
1931–32	4188	465	11.1	4	680	1.46
1931–B	1498	176	11.7	3	182	1.03

be no doubt. This contention is borne out to some extent at least by the figures in Table II. It should be noted that from an expenditure of from $100 to $150 per hundred accounts this store estimates the potential business resulting to approximate $16,000. This means that new business has been secured at a cost of something less than 1 per cent of sales which is, indeed, an exceedingly reasonable cost.

Although there are few supporting figures, it is generally agreed that selling more goods to the store's regular customers is an even more fruitful source of increased sales. Such an activity, unlike new customer solicitation, must be recognized as a control device by even the most exacting critics. A program with this end in view is predicated upon any one or more of several plans. Some stores, for example, have successfully used this contrivance for announcing department or store wide sales. Others use it with equal success not only for this purpose but also to promote new items at the beginning of each season. Perhaps more successful results have followed this use of customer analysis than any one other.

The revival of inactive accounts is an equally important objective. The figures in Tables III and IV present the experience of one store in this regard. An account is considered inactive after a period of extended disuse. As a corollary, one member of a family may use an account regularly while other members, erstwhile customers, for some reason have discontinued patronage. In either case, promotional activities usually fall on very fertile ground. One store estimates the potential value of their revived customer accounts at $53,750 per year, all of which they attribute to customer control.

The promotion of sales in allied departments also possesses possibilities for customer control. For example, a person buying a suit may soon be in the market for a pair of shoes. In a like manner, dresses may be sold to coat buyers; hosiery to shoe customers. This type of promotion possesses unusual potentialities in cases where the prospective purchaser is not at present a customer of the department which is being promoted. Many stores have enjoyed a great deal of success as a result of this type of promotion. Although the experience of some establishments is somewhat disappointing, their failure may very well be due to extraneous factors.

The promotion of sales to customers buying in one *division* but failing to patronize another has not been attempted on a sufficient scale to furnish conclusive evidence as to profitability. There have been some cases of successful experience, however. For example, the National Retail Dry Goods Association in their survey found one store which successfully sold bedding to apparel buyers. Again, cases of failure to achieve positive results may either be due to a poorly conceived program or to the basic unsoundness of the plan. There is still plenty of room for experimentation in this regard.

There is at least one important indirect function of customer analysis that warrants mention, namely, analysis of price lines. It is a well known fact that price lines are of tremendous importance from a merchandising point of view. It is possible through

[2] The data herein, as well as those in subsequent tables, were made available by P. H. Carr, formerly with the Standard Clothing Company, Minneapolis, from the experience of that establishment.

TABLE III
KEEPING ACCOUNTS ACTIVE—PERCENTAGE OF ACCOUNT INACTIVITY 1929 AND 1930

	B Group (Promotion, Sept. '28 to Dec. '30)	*E-F Group (Promotion, June '29 to Dec. '30)*	*W Group (No Promotion)*
Inactive in 1929	18.5%	27.1%	33.4%
Inactive in 1930	26.5%	33.1%	38.5%

analysis of customers accounts to discover most popular price lines, adjusting those in departments which are out of line. Indeed, in many cases lack of homogeneous price alignment may be the fundamental cause of an unprofitable department.

Control technique, of course, varies from store to store. Some have simple, homemade systems, others have elaborate mechanical systems devised by firms specializing in such work.[3] The information assembled differs materially according to the policy of the establishment. A system may be very simple, or on the other hand, very complicated. For example, a store might only wish to record data concerning general activity of accounts during the spring and fall seasons, sending a mailing piece to those not manifesting activity by a certain date. For this a very simple manual system could be used to advantage.

At the other end of the scale, a complicated breakdown of customer information including sex, marital status, credit rating, price lines patronized, general response to publicity efforts, purchases in each department and whether the customer owns or rents the home, might require one of the several very satisfactory mechanical systems. In this latter type, of course, a mailing list may be selected by the simple process of determining the list required and "shooting" them through the machine. In any case, the source of general data is the credit application supplemented by information from miscellaneous sources while purchase information may be posed from the ledger, from copies of monthly statements or from charge slips.

The type of system, then, depends upon the task to be accomplished. A satisfactory homemade system can, of course, be devised by the accountant in collaboration with the publicity executive. An elaborate system may be more effective in some instances but is no adequate substitute for constructive ideas. Regardless of the type of system employed, an important feature is constant study. For example, customer lists should be given frequent attention. The danger arising out of failure along these lines has been illustrated by Kenneth Collins in his book, *Road to Good Advertising*. Collins tells of Macy's former practice of sending mail to mothers about their children's needs. Occasionally, the company received replies indicating deep resentment concerning such importuning, due to the fact that the child concerning whom the company was writing had passed away months before. There is no way of determining the number of others harboring resentment as a result of a similar experience but not bothering to write. This is

[3] For an excellent discussion of actual techniques, see Bartlett and Reed, *Credit Department Salesmanship*, Chapter XI.

TABLE IV
RESULTS OF INACTIVE ACCOUNT SOLICITATION—RESPONSE AND COSTS

Date	*List (net)*	*Accounts Opened*	*Per cent Opened*	*Pieces in Series*	*Cost per Series*	*Cost per A/C Re-opened*
1928	2800	938	33.5	3	$315	$.34
1929	2053	1027	50.02	2	153	.15
1930-A	1096	154	14.	1	56	.36
1930-B	2673	1473	55.01	5	400	.27
1931	4487	1990	44.35	4	544	.286

TABLE V

COMPARISON OF RESPONSE FROM ENCLOSURE OF BUSINESS REPLY ENVELOPE AND GOVERNMENT ENVELOPE

Enclosure	*Number Mailed*	*Replied*	*Cost of Mailing*	*Cost of Reply*
Business Reply	2,000	163	$114.89	70.4¢
Government Envelope	2,000	264	$150.00	56.8¢

only illustrative of the ill-will improperly husbanded lists may engender.

Moreover, the letters themselves are of tremendous importance. The number mailed in a year is of primary consideration as continual importuning of clientele materially reduces effectiveness. As to quality of copy anything less than the best is flirting with failure. In order to discover the best, one should test as one proceeds. Only by this method can one determine which of the letters devised is most effective. That profitable testing is not confined to effectiveness of copy is indicated by the figures in Table V.

As a corollary, the *scientific control* device[4] should be employed. That is to say, a certain group of accounts should be left undisturbed for control purposes in order to determine whether the effect observed is actually the result of the particular stimulus employed or of extraneous matters such as the effects of general publicity or of changes in general business conditions. For an example of the use of the device in this connection, see Table III in which the W group has been set up for control purposes only. The importance of using the scientific control device in testing results cannot be overemphasized.

Planning in advance is perhaps the most important single fundamental underlying successful result from customer control. Only in this way can fatal errors be reduced to a minimum and success be assured. Planning assumes having the merchandising departments in order so that a well planned campaign will not be saddled with the almost insurmountable task of overcoming customer prejudice arising out of previous unpleasant shopping experiences.

Perhaps the most common impediment to success is the attempt to promote a sick department before remedying the ill. Any such attempt is generally a waste of time, money and effort. Harold B. Wess has stated that "The average store will spend from 3 to 5 percent advertising departments which are unsound but will not spend 0.5 percent to find out why they are unsound or why customers who patronize the store will not buy in these departments."[5] While it is quite true that customer control will sometimes help to discover a weak department, the problems involved though closely related are quite distinct. The one is an analysis of the customer; the other, the physical aspects of the merchandising department. In the former the subject of inquiry is customer buying habits, in the latter, stocks of merchandise, selling force, layout, competition, prices. Needless to say if the merchandising department is not in order the program of promotional activity will rarely be successful.

Undoubtedly the four most important principles of customer analysis as a sales promotional device then are having a well planned system which will bring out the information desired, having the merchandising department in order, careful planning of the campaign, and checking results. It is quite apparent that the first requisite is a sound system. Customers will not react

[4] Not to be confused with the term customer control. Scientific control has been used for centuries by researchers in the natural sciences for the purpose of isolating and measuring changes caused by specific stimuli. An interesting example of this is furnished by Paul De Kruif in his *Microbe Hunters*. De Kruif records as follows the musings of the eighteenth century researcher Spallanzani concerning Redi's experiment laying low the superstition that maggots and flies could arise out of putrid meat: " 'He takes two jars and puts some meat in each one. He leaves one jar open and then puts a light veil over the other one. He watches and sees flies go down into the meat in the open pot and in a little while there are maggots there, and then new flies. He looks at the jar that has the veil over it and there are no maggots or flies in that one at all. How easy! It is just a matter of keeping the mother flies from getting at the meat. . . . But how clever, because for a thousand years people have been getting out of breath arguing about the question and not one of them thought of doing this simple experiment that settles it in a moment.' "

[5] *Profit Principles of Retailing*, p. 46.

favorably, however, to the best kind of promotional effort if for some reason they dislike trading in a certain department. On the other hand, the most efficient department cannot be independent of intelligent and well conceived promotional effort. And it is quite evident that if repetitive errors are to be avoided and successful technical lore is to be compiled, careful recording of results is required.

Finally, it must be realized that any problem of customer analysis and control is of a strictly individual nature. Thus, much of the success of any one merchant is at the expense of his competitors. In the light of this fact then, it is quite clear that results of any plan will be affected to some extent at least by the inauguration of an effective plan by competitors. But such is the stuff of which competition is composed. Indeed, it is conceivable that the scheme may have to be employed as a defensive rather than as an offensive measure in which case outstanding positive results may not be forthcoming. Given reasonably favorable circumstances and a soundly conceived plan, however, customer analysis and control promises much as a sales promotional device.

ACCOUNTING AND CODE REGULATION

H. F. Taggart

The title assigned to me is sufficiently broad to cover a variety of topics. Accounting data and procedures impinge upon the N.R.A codes and their administration at a number of points. There is for example, the matter of keeping the books and auditing the accounts of Code Authorities. These bodies, whose precise legal status is still a matter of considerable uncertainty, are permitted to collect in a compulsory manner funds from the members of industries under their guidance, and to spend those funds on the basis of budgets approved by the N.R.A officials in Washington. Such funds are a public trust, fully as much as if they were tax monies in the hands of governmental bodies. The problems of accounting for these funds are similar to those found in governmental units, but interest is added by the facts that the objects for which such funds may properly be spent are uncertain and that those responsible for their expenditure are ordinarily quite unused to handling public trusts and deeply ignorant of the responsibilities attendant upon their position. Under these circumstances some unusual problems are presented to public accountants who are called upon to audit the books of these bodies.

Accounting data have been extremely useful in the making and amending of codes. The best example of such aid is the ascertainment of the effect of proposed wage and hour provisions on costs. In the men's clothing industry, for example, labor costs in certain shops were more than doubled by the code provisions as to maximum hours and minimum wages. Part of the investigation of the automobile industry now in progress deals with the possible effect on costs of the various schemes for regularization of the industry.

Investigations by accountants are necessary in order to test compliance by members of industry with code provisions relating to wages and hours, minimum prices, maximum discounts, trade-in allowances, classification of customers, etc., etc. At the automobile hearings we heard many tales of workmen who punched the clock for their allotted 48 hours per week, and then went on working, without punching the clock, for additional hours and, it is to be hoped, additional pay. This and other devices for evading wage and hour provisions are reputed to be common. These, as well as methods of getting around price provisions, may be well hidden in the accounts, but a careful audit may be expected to disclose most of them. After violations have been disclosed, further accounting investigations are necessary in order to ascertain the type and extent of restitution or adjustment required.

Accounting data are presented by many members of industry to bolster claims for exemption from code provisions. A number of very interesting cost studies have been made in order to ascertain whether or not inefficiency of workers, distance from market or source of raw materials, or other special factors make it unreasonable to require certain employers to live up to the code wages and hours.

The establishment of bases for specified minimum prices has called for the collection of a large volume of cost data. Excellent examples are found in the lumber industry and the retail solid fuel trade. Minimum lumber prices were established on the basis of weighted average costs of lumber production in the several lumber-producing territories. Minimum handling charges for solid fuels are based on studies of handling costs of the dealers within the numerous districts set up under the retail solid fuel code. It will be recalled that the national Code Authority for this trade resigned because the Division of Research and Planning in Washington insisted upon checking over all of these determinations. The "modal markups" applicable to the retail lumber dealers were developed by similar studies of cost reports. Cost studies were made for the establishment of minimum markups in the

paper distributing trade and for the price determination schedules in several branches of the graphic arts code. Practically all of these price control devices are on their way out, if the signs of the times can be believed.

Mention ought also to be made of the fact that many accounting firms are acting as the executive agencies of Code Authorities. These firms carry on many activities which are outside of the accounting field as narrowly defined. They collect statistical data, check up on violations of code provisions, act as confidential agencies for the filing of costs, prices, and other information, advise the Code Authorities, act as their counsel in contacts with Washington, keep the Code Authority books, and generally carry out the orders of the Code Authorities. Such arrangements have usually arisen because of previous connections of the accounting firms with trade associations or because the firms have been the auditors of important members of the industries for which they are now the code agents.

The use of accounting in code regulation with which I wish to deal most fully is that which is involved in the rule against selling goods below cost which appears in something like two-thirds of all codes. This rule is typified by the code for the heat exchange industry which provides that "no employer shall sell or exchange any product of his manufacture at a price or upon terms or conditions that will result in the customer's paying for the goods received less than the cost to the seller, determined in accordance with the uniform and standard method of costing hereinabove prescribed. . . ." The provision with respect to costing reads as follows:

> Every employer shall use an accounting system which conforms to the principles of and is at least as detailed and complete as the uniform and standard method of accounting and the uniform and standard method of costing to be formulated or approved by the Supervisory Agency, with such variations therefrom as may be required by the individual conditions affecting any employer or group of employers and as may be approved by the Supervisory Agency and made supplements to said formulated or approved methods of accounting and costing.

Provisions of this sort were originally hailed by many accountants with great satisfaction. It was freely predicted that code clauses like this would do as much for cost accounting as the federal income tax law had done for general accounting. This brand of optimism was well expressed at the 1933 International Cost Conference of the National Association of Cost Accountants by Association President Bullis, who spoke of "these golden days" and by Col. Nelson B. Gaskill, who said, "I assure you it is a very comforting fact to realize that there are so many cost accountants in the country, for your profession has before it as complicated, as important, and as large a task as now confronts the management of business itself.

"Your position in the great movement which dates from today is that of a vital leadership. You are no longer relegated to the background, to be called into action whenever business management finds that the margin between its costs and whatever prices it has seen fit to make, becomes too small. From now on, your work will be the vital basis for price making, for selling policy, for business control." These remarks were made before a single code had been approved, but the code makers lost little time in doing what they could to justify these hopes. Code clauses of the kind quoted appeared very early, and continued to flourish until June 7, 1934, when the Administrator issued Office Memorandum 228, which marked the abandonment by the administration of the attempt to control prices by forbidding sales below cost.

It is perhaps hardly necessary to say that the extreme optimism of certain accountants has not been justified by results obtained to date. The disappointment of these individuals was expressed by Charles R. Stevenson, speaking at the 1934 convention of the National Association of Cost Accountants. "The past year," he said, "has been a disappointing one to those of us who believed that the National Industrial Recovery Act meant what it said." Mr. Stevenson was among those who interpreted the National Industrial Recovery Act as a bar-

gain between the government and industry. As he expressed it, "Industry undertook to meet the wishes of the Administration in regard to reduced hours and higher wages, and, in return for this concession, industry was promised the right to enter into enforceable agreements which would bring about stability of price and profitable operation." Unfortunately, this theory, though false, was given encouragement in the early days of N.R.A by the officials in charge of code-making. Thus arose the common fallacy of drawing a distinction between the wage and hour provisions and the "fair trade practice" provisions, as if the wage and hour provisions were not themselves fair trade practice provisions of prime importance.

As a matter of fact, it requires a distortion of the National Industrial Recovery Act to read into it the bargain theory of N.R.A. The Act declares it "to be the policy of Congress . . . to eliminate unfair competitive practices" and, in a later section, describes "destructive . . . price cutting" as "contrary to the policy of this title." This is hardly more than a reaffirmation of Section 2 of the Clayton Act which forbids "price discrimination." What this section was intended to eliminate was, in the words of the Judiciary Committee of the House, the "practice of great and powerful combinations engaged in commerce . . . to lower the prices of their commodities, oftentimes below the cost of production, in certain communities and sections where they have competition, with the intent to destroy and make unprofitable the business of their competitors . . ." Perhaps, in view of the interest of Congress in purchasing power, the term "destructive price cutting" may also be interpreted as including the cutting of prices at the expense of labor—that is, price cutting which is made possible only by the reduction of wages below the code minima. In view of the historical attitude of Congress toward price-fixing, however, it requires a considerable stretch of the imagination to envision that body granting to industry any more than the barest minimum of control over prices. Such control certainly could not include such schemes as Mr. Stevenson and others would have liked to try.

What industry generally wanted was the power to determine minimum prices in dollars and cents, below which it should be unfair competition to quote or sell. A few industries got their wish, among them the lumber and coal industries, and the late lamented cleaning and dyeing trade. To the credit of the intelligence of most of the price-fixing advocates, it must be said that they recognized that nothing short of actual fixing of definitive prices could serve their purposes. Nevertheless, when they saw that they were not going to have much success in putting specific price controls into codes, they adopted the formula of forbidding sales below individual cost which, especially when coupled with open price provisions involving a waiting period, could be made to serve useful purposes.

On its face the prohibition of sales below cost appears to be emminently reasonable, and to those who know nothing about the complexities of cost accounting and the broad assumptions necessary in the determination of cost it seems relatively simple. A consideration of a few of the factors involved, however, should be enough to convince anyone that no attempt to enforce rules such as those quoted from the heat exchange code could be expected to succeed.

Most of the codes call for what is rather loosely termed a uniform cost-accounting system. It must be noted that what is necessary is a uniform method of estimating costs in advance of production, since 99 per cent of all prices are set either before the goods are produced or before their actual cost could be ascertained. A method of determining costs is a necessary adjunct to a method of estimating costs, since the estimates must be made on the basis of performance, but prices could not conceivably be controlled by a method of cost finding alone.

Official preparation of a uniform definition of cost as a basis for the prohibition of selling below cost is obviously necessary. In nearly all cases such a definition requires

expansion into a formula or a complete outline of cost finding methods. To prohibit sales below cost without defining cost would obviously be futile. Even the law against murder defines murder. Without a definition of cost, properly elaborated, any member of any industry could call anything he pleased cost, and justify his prices accordingly.

The necessity for the preparation of uniform methods of cost determination, however, does not imply that every member of the industry must use the uniform method and no other. This fact is recognized in the many code provisions which specify only that each member must use a system "as detailed and complete as" the uniform system. The uniform system, then becomes merely a minimum standard of cost accounting procedure, by which other systems are to be judged. If the member does not ascertain costs, or does so in a very sketchy manner, he must adopt either the uniform system or its equivalent in complexity and completeness.

Herein lies one of the features of looseness which make the rule unenforceable. There is never one way of determining cost, in any situation, that can be said with confidence to be the best. The result is that different members of an industry may, within limits, figure costs of the same product differently.

Even if the best method could always be determined for an individual, no one method would do for an entire industry, since differing conditions of operation necessitate different methods of attack on the cost problem. For example, two manufacturers making the same product, one by hand methods, and the other by the extensive use of machinery, must use different methods of cost determination. Herein lies the second cause for looseness in the cost determination scheme—a necessary defect, and yet a fatal one.

It is essential to the successful administration of any rule that it be uniform in its application and unambiguous in its interpretation. The necessity for looseness makes both of these characteristics impossible of ascertainment.

Cost determination methods, devised under code provisions which forbid sales below individual cost must, as far as possible, determine the *real* cost of the article or service in question. They must also, as a practical proposition, determine the *whole* cost. Both of these necessities create complexity in the uniform system.

The necessity of determining the whole cost arises from the necessity for the rule to be uniform in its application. A number of codes specify as the basis for minimum prices "cost of production" only. This rule seems, on the surface, less harmful than one which specifies total cost, but it is, as a matter of fact, viciously discriminatory. It omits what are usually known as selling and general administrative costs, and thus creates a distinct advantage for the concern which spends much money for such purposes. Its effect is well illustrated by figures from the flour milling industry which indicate that production costs are lowest in the very large mills and highest in the small mills. Selling and administrative costs, however, are higher in the very large mills than in the medium-sized mills. The result is that the overall cost of the very large mills is higher than that in the medium-sized mills, although lower than that in the very small mills. It is evident that a rule setting production cost alone as the minimum price basis would emphasize the existing advantage of the very large over the very small mills and would create an entirely new advantage of the very large over the medium-sized mills. There is no doubt that the situation in the flour milling industry is duplicated in a great many other cases.

Another consideration which militates against excluding any major class of cost items from a uniform system for code purposes is the fact that it is most difficult to be certain that items of cost are classified by all members of an industry alike. What some may treat as manufacturing costs are by others treated as selling or administrative, and vice versa. The mere establishment of a uniform classification of accounts, in as much detail as you please, will not remedy

this situation. The Interstate Commerce Commission and the state utility commissions have discovered this truth in the course of many years of attempting to obtain uniformity in the accounting practices of the industries in their charge. If this is true in those cases, how much more true is it in industries, most of which have had no experience whatever with uniform cost accounting? This fact, also, indicates that the omission of such considerable classes of expense leaves open a broad road for evasion, since nothing is easier than to juggle expense charges from one category to another, or to fail to make the proper allocations where costs should be divided between various divisions of the business.

Not only the whole cost, but also the real cost must be found. Otherwise the rule is obviously unreasonable. The codes forbid selling below individual cost, which logically means the actual cost, as nearly as it can be ascertained. Such a provision surely does not mean that sales must not be made below some figure other than the real cost.

The only simple cost systems are mere rules of thumb, such as labor plus materials plus 30 percent for overhead. These do not find actual cost; they merely arrive at an arbitrary figure which may be either above or below cost. Systems which find real cost are necessarily complex.

The science and art of cost accounting have made considerable strides in the past 25 or 30 years. Much thought has been expended in the solution of the infinity of problems presented in cost determination. Some problems may be said to have been solved, for the purposes for which cost accounting has traditionally been intended to serve. Faith in these solutions, however, begins to waver when it is contemplated to use the results of cost accounting as a rule of fair trade practice, with all the force of law. Many cost problems are far from solution for any purpose.

The N.I.R.A. is by its own terms limited to a period ending June 16, 1935. The N.R.A. is essentially an emergency organization and its rules are emergency rules. The rule against selling below individual cost is not an emergency rule; it is inherently a long-term rule, since its application inevitably involves the consumption of much time. The length of time involved may be illustrated by a consideration of the steps involved:

1. The system must be formulated.
2. The system must be submitted to and approved by the industry.
3. The system must be submitted to and approved by the N.R.A.
4. The system must be installed in the members' establishments.
5. After installation, it must be used for a time in order to get it into working order, before its results can be depended on.
6. A member must be cited for selling below cost.
7. His cost and the selling price must be proven.
8. It must be demonstrated that some legitimate excuse for selling below cost does not exist, such as the necessity of meeting competition, the disposal of distress stocks, or one of the other reasons that are recognized by the codes themselves to be valid.

How long each of these steps may take it is impossible to say. Experience indicates that in many cases they would take a very long time indeed. The Drop Forging Industry had a uniform system before the code was adopted. It had been in use some fifteen years and may be said to have had the approval of the industry although in the summer of 1934, only 21 of the 117 members were using it in its entirety. The Code Authority estimated at that time that installation of this system would take at least 60 days of the time of a cost engineer in each of the 96 plants unprovided for. How much longer would be required in each plant to get the system "shaken down" and in working order the Code Authority did not venture to guess. At any rate, they did not care to tackle the job. If this is true in a small industry which has had long experience with uniform accounting, no great amount of imagination is required to picture the situation in industries with thousands of members and no experience at all.

In view of the complexities already demonstrated, it is not difficult to see how easy it would be to evade a rule against selling

below individual cost. If such rules were continued in a resuscitated N.R.A the profession of "code cost expert" might be expected to become even more lucrative than that of "income tax expert." The code cost expert would be one who was efficient in the casting of legitimate doubt upon all findings of fact in cases involving the ascertainment of costs. His job would be a sinecure compared to that of the government accountant who had to sustain the findings.

Another factor which greatly facilitates evasion is the possibility of justification for the price complained of, even though it were proved that the price were below cost. The codes generally recognize justifications for selling below cost by making exceptions for the meeting of competition, for the disposal of dropped lines, and for similar compelling business reasons.

As a matter of fact, although an exception from the rule against selling below individual cost is obviously necessary, to permit competition to be met, this exception vitiates the rule to a remarkable degree. Competition does not exist solely between precisely identical products of the same industry, but also, and oftentimes more importantly between differing products of the same industry or between products of one industry and those of another. Nor is competition confined to national lines; the American manufacturer must meet the competition of foreign producers, unless Congress supplies an umbrella in the form of a tariff. Thus the manufacturer of ice must meet the competition of other ice makers and of natural ice. He must likewise consider the competition of mechanical refrigeration. The hardwood distillation industry finds some of its most important competition from foreign producers of methanol. In a sense, of course, all products are competitors for the consumer's dollar.

Here, again, a reasonably intelligent defendant can create a smoke screen of sufficient density to obscure the issue in any finding that the price complained of is not economically justified.

This problem exists, of course, in connection with any effort to prevent destructive price cutting. It is important to note, however, that this particular method of preventing destructive price cutting, namely, prohibiting sales below cost, does not eliminate this method of blocking a definitive finding.

In all this I have purposely not gone into the economic arguments with respect to the relationship of costs and selling prices. The practically complete non sequitur between the costs of any one producer of a commodity and the prices he can hope to get on the market is too well known to those familiar with the elements of economic theory to require comment. The naïve absurdities perpetrated by those unfamiliar with this axiom of economics illustrate the need for going back to fundamentals. I have attempted to confine myself to certain purely practical considerations, and to show from them alone that accounting and accountants have not lost much by the aboutface which Administration policy has taken.

It remains to examine the new policy and to see what part accounting may be expected to play in carrying it out. If the newspapers are to be believed, Congress may be asked at the coming session to extend the National Industrial Recovery Act in a modified form, including the present price policies.

Office Memorandum 228, which expresses these policies, in so far as they have been publicly expressed, rules out any "fixed minimum basis for prices" except in an emergency. This, by implication, bars prohibition of sales below cost. "Wilfully destructive price cutting," however, is declared to be "an unfair method of competition and is forbidden." The term is not defined, but a procedure for complaint and determination is set up. Under emergency conditions it is provided that a "stated minimum price" may be determined and that, for the period of the emergency, any sale below such price "shall be deemed destructive price cutting."

That these provisions fall far short of the desires of those who believe in the control of prices there can be no denying. That they go fully as far as the language of the present

Act justifies, however, seems equally clear.

Concerning accounting, the policy declares that "N.R.A will encourage proper cost finding and accounting provisions in codes." The approved model code clause relating to accounting reads as follows:

> The Code Authority shall cause to be formulated methods of cost finding and accounting capable of use by all members of the industry, and shall submit such methods to the Administrator for review. If approved by the Administrator, full information concerning such methods shall be made available to all members of the industry. Thereafter, each member of the industry shall utilize such methods to the extent found practicable. Nothing herein contained shall be construed to permit the Code Authority, any agent thereof, or any member of the industry to suggest uniform additions, percentages or differentials or other uniform items of cost which are designed to bring about arbitrary uniformity of costs or prices.

In another approved section the memorandum states that "it is intended that sound cost estimating methods should be used and that consideration should be given to costs in the determination of pricing policies."

Code clauses of this character do not indicate that cost accounting as an aid in checking destructive price cutting is to be thrown out of the window. They do, however, relegate cost accounting to what I believe to be its rightful rôle in the determination of pricing policies, namely, as merely one of many factors to be taken into account. An appraisal of the position of accounting as a factor in code regulation of unfair price competition discloses that its status under the new policy is considerably improved over that which the former policy would have attempted to bring about. The program of prohibiting sales below cost thrust cost accounting into a rôle for which it is not well fitted and which would inevitably have brought it into disrepute. Most of the so-called uniform systems presented for N.R.A approval were miserable make-shifts, hastily drawn up for one specific purpose, and would, if adopted at all, have been abandoned as soon as the single need for them was past. The new policy affords an opportunity for a sounder development of uniform cost accounting than did the artificial situation created by the no-selling-below-cost rules.

In contrast to the pre-N.R.A situation, it may be pointed out that:

1. There is more need than ever for knowledge of costs for managerial purposes, since employers are deprived of wage-cutting as a means of lowering costs;
2. The prohibition of destructive price cutting affords an inducement for knowing costs that did not exist before—a convincing demonstration that prices were justified by costs would be powerful defense in the hands of one who was accused of unfair price policies;
3. The program of promoting cost accounting is given explicit governmental sanction—the uniform systems are to be officially approved and the N.R.A stands ready to render aid in their formulation; and
4. Funds for the development and promotion of sound accounting methods, instead of being collected by the painful process of voluntary contributions, may be provided by Code Authority budgets to which all members of codified industries must contribute.

COMMENTS ON MR. TAGGART'S PAPER

I find myself in complete accord with practically everything that Professor Taggart has said. In fact, it would be decidedly presumptious for me to disagree with Professor Taggart because such disagreement might merely represent a number of minor prejudices. Professor Taggart has lived with the N.R.A. and knows better than I what its present virtues and shortcomings are. The only thing left for me, therefore, is to supplement what he has said by emphasizing what appears to me to strengthen the early impression that the N.R.A. will encourage cost accounting and give greater sustenance to the cost accountant.

Admitting that costs do not fix prices, it is, in my opinion, nevertheless true that code administration of industry will make industry cost-conscious. Prices will without doubt continue to be dictated by effective consumer demand. If that demand can be

met with profit to the low-cost producer, whether large or small, it will not be long before the inefficient or high-cost producer will be eliminated or will be forced to become an efficient low-cost producer; that calls for cost research. But low production costs alone will not prevent the march of some producers to the industrial graveyard, because if the quantities of production still materially exceed the demand therefore, the idle capacity costs must still receive consideration and must lead to failure for those unable to build an adequate market, to artifical stimulation of demand, or to the gradual withdrawal of investment from the overcrowded field. I cannot help but believe that these problems which, are, of course, much larger than pure cost accounting will nevertheless be submitted to the cost accountant for solution—or should I say to the industrial accountant—since cost accounting has enlarged its sphere beyond the factory and is seriously eyeing business in its entirety and in its relation to the economic world in which it functions.

I will admit with Professor Taggart that Simon Pure Cost Accounting is not the gateway to the future of the cost accounting profession and I must agree with him that cost accounting in its most expanded constructive features should be an instrument of management. But if cost accounting or industrial accounting becomes what I and many of my associates want it to become, I cannot see anything but enormous possibilities for the profession.

The N.R.A. thus appears to me to be a challenge to industrial accounting practitioners to bring into play talents which will begin to act because of a recognition that all business transactions are in reality cost matters finding expression not only in the processes of making goods and marketing goods but also in the processes of capital investment and economic readjustments.

The N.R.A., it seems to me, is but a first step in the direction of national economic planning—a national industrial budgeting in which there will be a coördination between the consumption potential and the capacity to produce; in which not only the production and distribution of goods will be budgeted for each industry but in which the flow of capital will be directed in those volumes required to meet most effectively the various demands for consumption goods. Whether or not such national planning will fall to the lot of industry itself, or will be administered by government, will depend almost entirely upon the ability of business to grow large enough in managerial capacity to perform the task. Industrial accounting is going to be relied upon, in my opinion, to do many of the tasks in this presumed industrial development.

It must be apparent to any close student of economic history and the social sciences, that the N.R.A., and other recent Federal legislations (The Securities Act, the A.A.A., the F.H.A. and the Securities Exchange Act) are based upon a new philosophy which recognizes that industry, because of its nation-wide expansion and significance, has social responsibilities and accountabilities; that it cannot longer go on creating only private profit to the damage of other economic factors but that it must produce social well-being; that it must perform the fundamental objectives of an economic system, that is, the satisfaction of human needs and wants. Both the capitalist and the accountant must become social-minded. Private profit must depend upon and come from social service. Is that not a challenge to all of us—teachers, capitalists and accountants? And if N.R.A. and its probable changes point in that direction does that not open wide the door of constructive service?

W. B. Castenholz

REPORTS TO STOCKHOLDERS

Paul L. Morrison

What information should be reported to stockholders? There is no generally accepted answer to this question. Activity on the part of the Federal Securities and Exchange Commission in promulgating rules for registration of new issues and for permanent registration of "listed" securities is directing attention to this vital question.

Stockholders may be divided into two classes: "controlling" and "investing." Controlling stockholders are in a position to know what is happening. Such stockholders combine personal ability and judgment with their capital investment, thereby becoming entrepreneurs. Other stockholders are more nearly pure investors though legally they are owners. They possess the legal right to vote on certain matters, but practically, theirs is solely a function of the decision to "buy, hold, or sell."

Since the controlling stockholders possess information needed, the question can be rephrased into "What information should be reported to 'investing' stockholders?" The logical answer is that vital information should be made available so that investing stockholders can arrive at a decision to buy, hold, or sell. Corporations increase their social responsibilities when they accept investing stockholders. An investing stockholder owns a perpetual, fractional interest of ownership without opportunity to combine human ability with his investment. The only way in which he can salvage part or all of his capital investment if he so chooses, is through sale; but in order to find a buyer, prospective purchasers also must be kept aware of pertinent facts currently. Therefore vital information must be made generally available.

The plea is heard immediately that a disclosure of certain information heretofore regarded as confidential will harm the stockholder because competitors will make improper use of such information or new capital will be attracted to the field if the results are favorable. Occasionally there may be merit to such a contention, but if the company does not possess some economic advantage which will withstand the light of publicity, there is a real question whether or not there is social justification in allowing such a company to obtain capital from the average investor.

Granting the necessity for dissemination of vital information, is it reasonable to assume that the average investor can make correct use of such information? The answer probably is in the negative. Nevertheless, the management will have done its duty and all investors will have equal opportunity to exercise their judgments on known facts. If an investor is not capable of interpreting the facts, society should either educate him or find a way of making it difficult if not impossible for him to function in fields beyond his capacity.

In order to make a sound decision to buy, hold, or sell, an investor must have a comprehensive knowledge of the forces at work tending to expand or contract general business. He needs to have an opinion also of the trend of interest rates. The forces at work are economic, social, political, and psychological, and therefore are complex. Mastery of these problems is individual and the management has no responsibility to provide stockholders with a general business and investment education.

The second duty of an investor is to know industries and the trends at work. A study of the annual reports of the important companies in an industry should provide an intelligent stockholder with a good perspective of the trends prevailing in the industry. A stockholder needs to comprehend the operating as well as the financial situation in an industry. He is interested in the forces which produce net income from operations because this is the amount which is available for division among those holding financial claims or interests—creditors and stockholders. Net income from operations may be increasing in certain industries at a given

time, may be moving sidewise in other industries, and may be decreasing in others. It is vital to the holder of bonds as well as of stocks to know these trends and to perceive changes in ample time.

A stockholder is interested fundamentally in present and prospective dividends. If it is reasonable to expect that dividends will be inaugurated or increased, price action of the stock will tend to be favorable. Likewise, if prospective purchasers are willing to capitalize such payments at progressively lower interest rates, price action will also tend in a favorable direction. In other words, price of a given security is determined in the market by marginal purchasers and sellers after each has capitalized prospective dividend payments. This requires a judgment on the part of stockholders of the amount and trend of dividend payments and also an opinion as to how the market will evaluate these factors.

Payment of dividends is determined by the directors who in turn voice the desires of the controlling stockholders. Withholding dividend payments which should be made, reducing payments when they need not be reduced, or increasing them when they should not be increased, provides the insider with tools for manipulation if he so desires. An honest management will not undertake to manipulate the stock for its own benefit, and protection against unfair managements can be improved by a higher standard of the public consciousness.

While the stockholder cannot know in advance of decisions to be made with regard to the payment of dividends, he should be provided with sufficiently complete and accurate information about the company which he can use in conjunction with his knowledge of general business and interest-rate factors at work so that he can determine the probability of the maintenance of the present dividend or prospects for increases or decreases. He should not be surprised when action is taken.

Cash resources of a company provide the means for payment of dividends. The stockholder is interested in changes in assets and liability of the company which will result in more or less cash becoming available for dividends. The principal source of change in cash available for dividends is income or losses. Modification of inventories and accounts receivable, additions to or sale of fixed assets and investments, and changes in the amount of longer-term debt and stock outstanding affect the amount of cash available for dividends. The stockholder is interested in these changes, and the management should present frequent statements which will enable the stockholder to observe the changes which are taking place. Managements would render a service to stockholders if they would present a statement which attempted to account for the changes in cash during the period under review. Investment analysts frequently prepare their own statement of application of funds or similar statement from incomplete information. Managements generally have such statements for their own use. Why should not managements make such information available so that stockholders can judge administration of cash by the management and come to some conclusion as to the probable trend?

The major factor, however, is income—prospective income. Analysis of income is first operating, then financial. A net profit from operations results from selling a sufficient volume of goods or services at prices which produce total revenue in excess of costs. Net from operations is then divided among the various "equities" in the enterprise. The financial relationships determine this division. These elementary concepts are the foundations of successful analysis.

An analyst needs rather complete information about historical income in order to ascertain trends and estimate the future. Sales or revenue must be available annually and quarterly, and it is only a matter of time until we shall recognize the necessity for monthly reports of sales. Although difficulties increase with any shortening of the accounting period in the determination of accurate net profit, sales are more definite and subject to less error. At least, a company which does not release promptly the amount of its sales is not fair to its investing stockholders.

Sales or revenue are the product of volume and price. Where the product or service is reducible to logical units of tons, feet, number, kilowatt hours, etc., volume as well as dollar value should be made known. Where this is not possible, sales should be classified by reasonably homogeneous types so that the stockholder may know the character of enterprise in which his funds are invested. It has been contended that a disclosure of both volume and sales will reveal price and will disclose discrimination between customers. One answer is that most businesses are too complex for such detection. Another is that the trend is definitely in the direction of publicity of price under codes and business practices. A disclosure of unit prices, even if only rough and approximate, enables the stockholder who is following developments in the industry to appraise the effects of known changes in prices of products or services sold by the company. Detailed reports of public-utility companies have enabled stockholders to anticipate the effect of probable or pending rate cuts. Effect of changes in prices of steel can be measured approximately because of the completeness of information released at frequent intervals by the industry and particularly by U. S. Steel Corporation.

Many important companies today are engaged in several types of operations some of which are sufficiently different to be classified as separate industries. The relative importance of those fields of activity should be revealed through publication of sales by major divisions. One such company today is functioning in four distinctly different fields, two of which are generally known to be declining in both sales and net income, but the company not only does not report facts separately by division but does not even report sales as a whole. Few accountants divide sales into major departments or divisions in their audited income statements. They are interested primarily in presenting simple, over-all statements. In most cases the stockholder needs this information; if it is not supplied by the accountants' statements it should be supplied elsewhere in the annual report.

Operating costs frequently are shown in annual reports in one lump sum. The stockholder who is interested in estimating a trend of net earnings gets only minor help from such a statement. Material, labor, and overhead are the principal elements in operating cost. Costs should be made available at least in that much detail. Not only should material costs be reflected but the accounting method pursued should be explained. Accountants tend to decide for themselves what principles shall be followed in a given instance, but are not always careful to explain those principles. During periods of rapidly rising or falling prices, both costs and earnings are affected by the method of determining cost of materials used. Inventory profits of a non-recurring nature or the postponement of inventory profits to a later period are not disclosed in the typical accounting statement. The stockholder is seriously handicapped in attempting to estimate future earnings and dividend payments by lack of this vital information. Although accounting statements are particularly vulnerable at this point, income statements continue to be issued in abbreviated form by accountants with a calmness that defies comprehension. If one cent is not accounted for in cash, turmoil results, but a twenty per cent variation in net profit which would result if another logical method of computing material costs had been used passes by without comment, and the accountant issues his statement with a degree of finality which shocks the stockholder who later learns what transpired.

Consistency in method is a recognized principle of accounting, but that does not provide the stockholder with a clear picture of what is actually transpiring to affect the value of his investment. Consistency is of value only if the stockholder knows what method has been used. We recognize the *mechanical* necessity for the issuance of one and only one accounting statement at a given date or for a given period. Nevertheless, the stockholder is interested in knowing what has happened and why. He is concerned not with the form but rather with the substance. If two or three methods of calcula-

tion present a more complete picture than does one method, then the conscientious stockholder feels he should have this information. If the accountant does not supply the information the management should. A stockholder has a right to know whether profit results from operations or from fortuitous speculation in commodity prices.

Another major element in cost is labor. Currently stockholders are interested in the effect of pending "social security" legislation on costs. It is proposed that some of these costs shall be assessed as a percentage of payroll costs. Few corporations reveal their labor costs. Unless the stockholder happens to be intimately familiar with the industry, he has difficulty in ascertaining whether labor constitutes twenty or sixty per cent of the total cost of operations. Without a knowledge of the relative importance of material and labor, the stockholder cannot estimate the influence of changes which he knows are taking place.

Overhead costs should be segregated to show whether or not they constitute an important element. Not only such items as depreciation and depletion, which are noncash items and entirely a result of judgment obviously, should be shown separately, but the annual report should explain in considerable detail the methods of calculation used. Where the amount of capital assets employed is relatively large, maintenance and repairs should be designated separately so that they can be considered together with depreciation and the methods employed in valuing capital assets. Payments to officers and controlling interests also should be revealed if relatively substantial.

If the stockholder has a clear picture of price and volume of sales on the one hand, and of material, labor and overhead costs on the other, "net income from operation" becomes significant. If, in addition, net is classified by major divisions or departments, the stockholder begins to have a "feel" of the situation.

"Other income" frequently is explained satisfactorily by sources and character. An annual report is sadly lacking which omits a description of other income. "Operating" and "other" income combined produce the amount available, during the period under review, for distribution among creditors and "owners." The typical annual report reveals interest and dividend payments and accruals quite satisfactorily. Funded debt and net worth are revealed in detail on the average balance sheet so that the "financial" section of income statements and surplus accounts can be checked readily.

With an eye on future dividend payments, the stockholder estimates whether or not more or less funds will continue to be made available from earnings and whether or not they will be paid out promptly or at a later date. The current working capital position is an important factor in the timing of dividend payments and changes. It is essential, therefore, that current assets and current liabilities be presented accurately. Valuation methods used in inventories, receivables, and securities should be described. With similar information at the beginning of the period and explanation of material costs and credit sales in the income statement the stockholder has a comprehensive picture.

Accountants spend much time debating methods of valuing buildings, machinery, equipment, and similar facilities. The stockholder would like to know the methods employed in valuation and verification of these assets, but he is much more concerned to know whether or not the facilities are adequate and are properly located for economic production. Today, as never before, undermaintenance over a period of years, improvements in methods, and shifts in products and methods must be reckoned with. The stockholder would like to be informed honestly by the management whether or not the company is able to take advantage of its opportunities or whether some of the current funds which he has been expecting as dividends must be used in rehabilitation and expansion.

Needless to say, permanent investments, if important, should be explained fully in the annual report. The same is true of intangibles. Transactions in the company's own securities should be explained in detail. This applies to new issues and to purchase

and sale of shares of stock and bonds already outstanding. Surplus reconciliations are now standard for annual reports.

It has been suggested that condensed and abbreviated financial statements be supplied to stockholders and more detailed statements supported by appropriate schedules be supplied to professional investment advisers. The advisers recognize the necessity for everything referred to above and are attempting by one means or another to obtain it. However, they do not need special privilege or advantage to justify their existence. Their function is to determine policies and choose appropriate items through exercising judgment. They would prefer that complete information be available to all, including themselves, for only in this way will they obtain all the information they need.

This article has been discussing the contents of annual reports without specifying whether the management or the auditors should supply the particular information. The management is responsible to the stockholders for a report of its stewardship. It employs public accountants to audit the company's records and prepare financial statements which "*in their opinion* correctly set forth the financial position of the company and the results from operations" during the period under review. Too frequently the ideas of the management as to the contents and form of the statements are followed by the auditors as long as "good accounting practice" is not violated. Everyone recognizes the practical necessity for keeping the financial statements reasonably simple, but that does not justify omission from the annual report of information vital to stockholders. If information recognized as vital is not contained in the financial statements, it should appear in the body of the report. Too frequently auditors emphasize literal truth. This is a natural result of "making figures balance." Likewise, they have not been "investor"-minded. In the discussions leading to "good accounting practice" the needs of the minority investor have not been paramount. A balance sheet and "earnings per share" too frequently are considered sufficient for the investor. Such simplification of our complex economic society is one of the facts which no doubt contributed to the widespread interest in the stock market during the last decade. Should the average investor appreciate more of the complexities of the problem he would not treat our economic system so lightly.

Contents of quarterly and monthly reports cannot be treated in detail here. Suffice it to say that more rather than less information is needed. Also, the needs of the investor should constantly be kept in mind.

Although the comments which have preceded set a relatively low standard which could be attained without much effort, few corporate annual reports in the industrial field qualify. Most railroad reports and those of quite a few public utilities are more nearly satisfactory. Few, if any, municipal corporations could meet similar standards of disclosure of information vital to investors. We should hasten to say, however, that rapid progress is being made in all fields toward a more reasonable goal. Federal legislation is crystalizing public opinion and helping to raise standards.

In view of what has been said it should be of interest to examine an article published in the February 15, 1935 issue of the Bulletin of the American Institute of Accountants on the subject "Disclosure of Sales, Cost of Sales and Gross Profit." The Institute is fearful that disclosure of sales, cost of sales and gross profits "may damage the competitive position of certain types of companies." Representatives of the Institute apparently were instrumental in inducing the Federal Securities and Exchange Commission to issue regulations to the effect that the commission may keep in its confidential files, information about sales, cost of sales and gross profit "if the company concerned shows reason why public disclosure of the data might injure it."

The Institute committee said "that while an investor might be helped by the disclosure of sales and sales statistics, in that he could, perhaps, follow the progress of the business and appraise its position in the industry, nevertheless, if the disadvantages to him as an investor exceeded the benefits, he would

doubtless prefer to dispense with the information were the choice left with him."

In preceding paragraphs it has been asserted that sales, sales statistics, and even the details of cost of sales are vital to the investor. The Institute committee recognizes this principle but infers that public disclosure of such data may be harmful to investors in some companies. The committee then submits eight illustrations of typical cases where harm may result. It is worth our while to look at those illustrations.

(1) Corporations in this country competing with foreign industries, as in the dye and chemical industry, would be at a disadvantage if their profit margins became known to foreign competitors, who would be under no obligation to disclose like information.

Since when have international chemical prices been determined by gross profit margins of American chemical companies? If chemical company profits are so vulnerable, should not the typical "investing" stockholder have some knowledge of the margin if it is excessive before the "ignorant" foreign competitor "gets wise" and forces a reduction in that margin? Officers and directors of the companies and their friends know these facts. They frequently are more or less active in the company's stock. They have convinced the accountants and the accountants are now trying to convince the Commission that the "investor" should not have this information. In most cases, the company's bankers, investment trusts, large investors, and investment counsel firms also have this information. Why should it not be general information to investors and prospective investors? It is unfortunate that accountants have placed the chemical industry at the head of the list of those asking for special dispensation. That industry has raised capital from the public and the public is entitled to any material information regarding it.

(2) American companies carrying on a large volume of business in certain foreign countries might be unnecessarily exposed to efforts to assess larger foreign taxes against them if their sales and profit margins were made public.

There may be foundation for this argument in certain isolated instances but it would appear that the amount of net profit is a much more vulnerable target for taxes than sales or profit margins. If the committee's argument is valid then operating profit should not be shown and it is only a step to elimination of profit-and-loss statements, surplus reconciliations and even the balance sheet itself.

(3) Relatively small companies dealing in only a few products, frequently in competition with a single department of a larger corporation, might be placed at a disadvantage from a competitive point of view, because the larger companies, by publishing sales in bulk, would not show detailed information applicable to the specific products on which the smaller competitors would be required to divulge information.

This argument contains the same fallacy as (1) above. It assumes that an industry gets its information from published reports. At a time when the general trend is toward more complete facts in business and investment, one would expect to find the Institute in the vanguard crusading for presentation of full and complete facts.

(4) Manufacturing companies listed on national exchanges frequently compete with unlisted companies which would not be subject to the requirements of the securities exchange act. The listed companies, in such instances, by disclosing sales would reveal information of benefit to unlisted competitors without receiving similar information from them.

If this argument is valid then all companies with listed stocks are justified in keeping material information from investors. Every listed company can find an unlisted competitor. But why stop with sales? Elimination of the entire profit-and-loss statement is just as logical. It would appear equally important to dispense with the balance sheet because disclosure of a weakened current position would give unlisted competitors their opportunity to attack. Accountants would be truly embarrassed if the Institute's suggestion should lead to the challenging of all financial statements.

(5) Companies manufacturing a small number of items which are used as raw materials by other manufacturers would if required to disclose such information, divulge their profit margins to their principal customers, who are usually few in number and often financially stronger than the vendor company, with consequent danger of efforts to force reduction of prices.

(6) Disclosure of sales volume and profit margins of companies which have developed specialized methods of merchandising and selling, such as mail compaigns, door-to-door selling, etc., might attract competitors who would duplicate these methods. The pioneers in these fields believe that the information which would be disclosed is in the nature of a trade secret and that disclosure would injure their stockholders.

(7) Pioneers in new fields, who have often spent large sums in research and development, as a result of which they now enjoy large profit margins, fear the irresponsible competition, with inevitable price-cutting, which would be attracted if profit margins were disclosed. The original companies might be unable to make sufficient profit to amortize preliminary experimental expenses. A high gross or net profit in relation to sales does not necessarily mean that prices are too high. Other elements, such as rate of inventory turnover, capital requirements in relation to sales, expenditures for research and development, and the risks of new enterprises, may make a high profit ratio economically sound, although disclosure of that ratio might invite competition that is economically unsound.

(8) Companies must enjoy some good years in order to be able to carry on through lean years but if at certain times profit margins appear to be attractive, disclosure of the facts may invite competition which will result in ultimate overcapacity.

All of these arguments assume that wide-profit-margin industries are not recognized by potential competitors. The validity of this assumption can be admitted only in a limited number of cases, not as a general rule. If wide-profit-margin industries are so vulnerable, should not investors know the size of the margin or are they supposed to have more intuition than competitors?

In addition to the eight illustrations of cases which might be detrimental to the interests of investors, the committee submits three illustrations of cases in which the publication of information regarding sales, cost of sales and gross profit might be actually misleading. If sales and cost of sales are misleading, would not the resulting profit also be misleading? What financial statement is not misleading in some respect in the hands of the unskilled person? It is difficult to see how less rather than more information clarifies the facts.

Practically every corporation in the country can substantiate the necessity for privacy of sales and cost of sales by one or more of these eleven excuses. Any management which desires, for personal or other reasons, to report incomplete information to investors now can hide behind these or similar excuses under the guise of protecting the investor.

Analysis of financial statements is both quantitative and qualitative, with the latter more important. The amount of sales or revenue is important in determining the "quality" of working capital, receivables, inventories, fixed property and debt. The amount of sales or revenue, therefore, is a "material fact"[1] for investors.

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[1] Bulletin of American Institute of Accountants, No. 130, Feb. 15, 1935, pp. 8–9, reports that Robert E. Healy, member of Federal Securities and Exchange Commission, in a public address defined "material information" as that information which a man of reasonable prudence should require in forming a judgment of the value of a security as an investment.

THE EFFECT OF RECENT LAWS ON ACCOUNTANCY

ROBERT E. PAYNE

ACCOUNTING is a young profession, but in recent years the public has come to realize that an accountant has some ability beyond that of keeping books. Its recent recognition in the various federal and state laws, stock-exchange regulations, and the Investment Bankers' code of fair competition should bring about a still greater recognition of the value of its service. The lawyer's interests are mainly those of his client, but the accountant is called upon to report to his client, his client's creditors and bankers, his client's security holders, and the public. The average audit report serves many purposes, and the accountant's responsibilities extend to all the readers of his report.

The accountant's moral responsibilities are no greater since this legislation has been enacted; the moral obligations have always existed. They may now be recognized as extending to a much larger group—possibly more to the public in general and less to individual clients—but they are, nevertheless, the same responsibilities now legally recognized. As one prominent accountant says, "We have no greater moral responsibilities now but the legal responsibilities are being crystallized and definitely defined." Furthermore, the accountant has reason to welcome legal requirements which cause the client to accept sound principles of accounting. For example, surplus should appear on the balance sheet divided into its various parts. Clients have often objected to this segregation for obvious reasons of their own, but in Michigan the argument ceased to exist when the new "Michigan Corporation Act" was amended to read, "A corporation shall at all times keep its books in such manner as to indicate clearly the division of the surplus accounts between surplus arising from earnings and surplus arising from other sources and it shall likewise indicate clearly such items in its annual reports to the State and its annual report to its shareholders." Thus, the Michigan law enforced accounting ethics by permitting accountants to refer to it as well as to their own principles, being thus able to insist that the client's interests and their own were one. Reference to standard practice and the law combined may later remove many questions of procedure from the realms of argument and make it easier to convince the client that proper disclosure is necessary for his own safety.

RECOGNITION OF ACCOUNTANTS

Recent laws which have given recognition to accountants include the following:

1. The Securities Act of 1933 which deals with the registration of new securities for interstate sale requires a certified balance sheet of recent date and a certified statement of earnings for three years all of which must be prepared by independent public or independent certified public accountants. Probably few issues will be offered wholly intrastate because the issuing corporation must be resident and doing business within the state, and the sale or any communication regarding it must be handled wholly within the state. The danger of violating the act by accidentally crossing a state line, together with the sales resistance which might arise because of the failure to register, may induce even purely intrastate flotations to be registered that would normally be exempt.

2. The Securities Exchange Act of 1934, which provides for the registration of listed securities, and which is administered by the same Commission requires:

(I) balance sheets for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants;

(J) profit-and-loss statements for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants: and

(K) any further financial statements which the Commission may deem necessary or appropriate for the protection of investors."

Many are doubtless familiar with Form 10 which was recently issued for the use of companies registered on national exchanges. It requires certain certified balance sheets, certified earnings statements, and other accounting information to be filed with the Commission and with the Exchange before July 1, 1935.

3. A third important recognition of public accountants is contained in the Investment Bankers' Code of Fair Competition approved on November 27, 1933. Section 1 of Article IV of the Code refers to the agreements which are to be required of the issuer by the investment banker originating a new issue; the first paragraph of Section 1 (b) states these requirements in part as follows:

ANNUAL FINANCIAL STATEMENTS.—To cause for each fiscal year to be prepared by independent public or certified accountants, an Income Statement, Surplus Statement and Summary of Changes in Reserves for such fiscal year, and a Balance Sheet as of the end of such year of the issuer as a separate corporate entity and of each corporation in which it holds, directly or indirectly, a majority of the voting stock together with such information as may be necessary to disclose all intercompany holdings and transactions; or, in lieu thereof, eliminating all intercompany transactions, a similar set of consolidated financial statements of the issuer and any or all of its subsidiaries accompanied by financial statements of the issuer as a separate entity and of any subsidiary not consolidated.

The Investment Bankers' Code also stipulates the treatment of certain accounting matters and, provided the accountant agrees with such treatment, it should be easier to convince the client that proper and informative methods of display should be employed regardless of whether or not the client is issuing or listing securities. For example, the Code refers to:

1. certain information to be given in the consolidated statements;
2. the treatment of nonrecurring items of profit and loss;
3. the disclosure of the basis of which the accounts of foreign subsidiaries are included in any consolidation;
4. the disclosure of the basis of valuation used to compute the figures at which the principal asset items are carried;
5. full disclosure as to any liabilities secured, and the nature of such security;
6. the separation of loans and advances as between the issuer and subsidiaries not consolidated;
7. the separation of amounts due from directors, officers, and employees;
8. the treatment of stock dividends as income only up to an amount not greater than that charged against earnings, earned surplus or both of them by the company paying such stock dividends; and
9. full descriptive disclosure of any material change in depreciation rates, policies, or in accounting principles or their application.

4. After July 1, 1933, the New York Stock Exchange required that all listing applications contain the certificate of public accountants qualified under the laws of some state or country, certifying to the correctness of the balance sheet, income statement, and surplus statement for the most recent fiscal year. Applications also included an agreement to the effect that future annual reports to stockholders are to be similarly certified. Since then, of course, the Securities and Exchange Commission has introduced its own requirements regarding certified reports to be filed with both the Exchange and the Commission.

The above-mentioned classes of recognition do not include state corporation acts, state blue-sky laws, or income-tax returns. State blue-sky laws may change their requirements to conform to the Federal Act, and many of them now require that financial statements to be certified by independent public accountants. State corporation acts are also beginning to recognize independent auditors and one or two already require that the accounts of corporations shall be audited annually by certified accountants. In one state now the selection of auditors is left to the stockholders.

RESULTS OF RECOGNITION

All of these classes of recognition are important to the profession. They are important also to the lawyer because the accountant and the lawyer must work together in the preparation of registration statements and must therefore meet on a common ground of mutual coöperation and understanding. When lawyers write new laws they should more and more recognize the value of suggestions from accountants in the preparation of those parts of the law which pertain to financial matters. A committee of the Chicago Bar Association, when drafting the new Illinois "Business Corporation Act," called upon local certified accountants to assist them.

Our national associations, the American Institute of Accountants and the American Society of Certified Public Accountants, and our various state societies have also been called upon to assist in drafting the accounting rules and regulations for the administration of the Securities and Securities Exchange Act, the Investment Bankers' Code etc. For example, Form 10 for corporations listing on national exchanges, and Form A-2 for corporations issuing new securities, both recent productions, are full of suggestions made by accountants. Many of the suggestions made a year or more ago are just now being accepted, and while all accountants do not agree with the suggestions as adopted, many sound and accepted principles of accounting which have previously been entirely dependent upon the accounting profession to enforce, are now required by law.

In the past it has been necessary to meet and refute the client's ideas of presentation entirely on the grounds of personal opinion but now whether or not the client's securities are listed or ever will be listed, these regulations have set a standard which can be pointed to as being at least the minimum practice which must be followed.

The following are a few examples of the new requirements of Forms 10 and A-2:

1. Items to be included as current assets are those generally realizable within one year.
2. Reserves provided against current assets such as accounts receivable are to be separately shown, and are to be deducted from the specific assets to which they apply.
3. Funds in closed banks are not to be included in current assets.
4. The aggregate value of marketable securities must be stated if another basis of determining the balance-sheet amount is used.
5. Notes and accounts known to be uncollectible are to be excluded from both the asset and the reserve.
6. Major classes of inventory are to be shown as well as the basis of valuation.
7. Amounts due from officers and directors must appear.
8. The basis of determining the value of certain assets such as investment securities, etc. is to be disclosed.
9. Indebtedness to or from affiliated or subsidiary companies is to be separately shown.
10. Details of changes in fixed assets and changes in reserves for depreciation are to be given.
11. Substantial items of deferred charges, accrued liabilities, etc. must be separately stated.
12. The division of surplus as between paid-in, capital, and earned is to be stated wherever possible and an analysis of each surplus account for the past year is to be disclosed.
13. Treasury or reacquired stock is preferably to be shown as a deduction from either capital or surplus or both, but if shown as an asset it is to be accompanied by reasons and the number of shares and the basis at which carried must be shown.

One fact of importance which has been brought home to accountants is that with or without our help the requirements and regulations of various commissions are setting and will continue to set general standards for us to follow. A client may not intend to issue new securities, and his present securities may not be listed, but his annual

reports to stockholders, bankers, and others which are certified may later be judged in the light of what constitutes reasonable investigation, reasonable grounds for belief, and adequate and proper display as laid down by those bodies. Court proof of the reasonableness of an investigation may in time to come be established or refuted by reference to these same rules. Convention and uniformity of practice are important as proof and whether or not the client or the accountant ever becomes directly liable under the law, the accountant's work is apt to be publicly judged by such standards.

STATE CORPORATION LAWS

Unfortunately orthodox legal concepts of accounting matters which appear in most state corporation acts do not conform very closely to accepted principles of accounting. The Illinois Act comes closer than most of them, but still leaves much to be desired by accountants. State acts in general have not progressed in many years as fast as Federal acts and regulations have progressed in a few years. This is natural because state acts have often remained without amendment for long periods of time and when originally drafted accountants were seldom consulted. There is the tendency to copy the provisions of other states in order to attract corporations in competition with other states.

In a study of some of the accounting features of several state corporation acts which was made by a special committee of the American Institute of Accountants, it was appalling to note the different (and indifferent) treatment of accounting matters and the varied and loose use of accounting terminology, and sometimes even the apparent uncertainty as to the original meaning of the wording itself.

A few differences of interest to accountants are as follows:

1. Many state laws are careful to stipulate that stock transfer records, etc., be kept, but are silent as to any regular books of account to properly record business transactions.
2. Only two states require audits by public or certified public accountants.
3. The power to purchase treasury shares is specifically granted in many states, left to inference or without prohibition in others; and in one state (Kansas) the courts have held that no such power exists.
4. Definitions are often almost totally lacking.
5. The power to purchase treasury shares, when specifically granted, may be expressed in several different kinds of wording and is seldom accompanied by definitions. For example:
   (a) "not when it would cause an impairment of capital,"
   (b) "except from surplus."
   (c) "Not at a time when the net assets of the corporation are less than its stated capital, or which would reduce its net assets below its stated capital,"
   (d) "only out of the surplus of its assets over its liabilities including capital,"
   (e) "out of its surplus funds by resolution of its stockholders,"
   (f) "out of surplus available for dividends," and
   (g) in good old Illinois language "not when its net assets are less than the sum of its stated capital, its paid-in surplus, surplus arising from appreciation in value or revaluation of assets, and any surplus arising from surrender to the corporation of any of its shares, or when by doing so its net assets would be reduced below such sum."

It will be noted that the Illinois wording is in effect a backhanded definition of earned surplus. Of course, the definition backs into earned surplus by a process of elimination but, no doubt, it is sufficient for its purpose.

The question of the allocation to surplus of a part of the consideration received from sales of no-par shares at the time of the original sale is another matter which confronts or affronts many accountants. Most state laws permit an allocation to surplus available for dividends by sole action of the board of directors, but accountants in gen-

eral feel this ought to be a function of the stockholders. The accountant must therefore decide what constitutes proper notice to shareholders for the purpose of his own report. Delaware permits all, or practically all, of the consideration to be allocated to surplus; Michigan limits it to 50%; Illinois limits it by aggregate preferential amount payable upon preferential shares having a preferential right in the event of involuntary liquidation; and so on throughout all the different laws.

The question of the proper treatment of treasury shares on a balance sheet has long been a question for discussion by accountants. Most of them have clients in several different states, and therefore the confusion is increased because of the necessity of showing treasury stock according to proper accounting methods, and furthermore in accord with the particular state law under which the corporation is organized. If the state laws permitted treasury stock to be purchased only under certain restrictions but required it to be immediately canceled, there would be no difficulty but this of course, is not the case. Although accountants have thought of treasury shares as a reduction of capital, such shares do not usually reduce capital legally until some formal action is taken to cancel them.

In some states, treasury stock may be purchased out of any surplus; in Illinois it may be purchased out of earned surplus; and in California it may be purchased, with some exceptions, only out of earned surplus and at the same time it must be charged to surplus on the books of the corporation. Of course the cost of Treasury stock restricts the surplus available for dividends or for further purchase of treasury shares in almost every state where purchase is permitted. In order to arrive at some uniform method of balance sheet treatment regardless of the client's state of incorporation, some accounting firms have adopted a plan of deducting the cost of treasury shares held for indefinite resale from the combined total of capital and surplus with a parenthetical note opposite each surplus account affected as to the amount of such restriction.

Treasury stock may be defined as shares of capital stock which, after being issued fully paid, are subsequently required by the issuing corporation by purchase or otherwise. Its status as treasury stock is lost when it is formally canceled by legal proceedings. It does not include stock which was held against canceled subscriptions.

The treatment mentioned above (i. e., deducting from combined capital and surplus) concerns only treasury stock held for resale, but of course, there are other classes of treasury stock which present problems as well. For example:

1. Treasury stock may have been resold before the accountant's certificate was prepared or before the balance sheet was published. In that case it may seem unfair to treat it as a deduction from net worth because its sale has actually increased the current assets just subsequent to the balance sheet date.
2. It is sometimes reacquired for the definite purpose of resale to officers and employees, or under other conditions indicating clearly that the shares are saleable without restrictions and have a ready market for the quantity held and that resale will actually occur. Some accountants hold that under those conditions treasury stock may properly be shown as a separate asset, on the balance sheet specifically stating the number of shares and their cost.
3. It may have been purchased for definite cancellation (for example: preferred purchased for retirement) but formal cancellation may not have taken place at the date of the balance sheet. The question then arises as to whether it should not be deducted from capital at par or stated value even though at the immediate date of the balance sheet the formal act of cancellation had not been consummated.

However, as stated before, where no definite action has taken place, or is definitely indicated as about to take place, treasury stock may best be deducted from the combined total of capital and surplus at cost and thus the balance sheet shows:

1. The par or stated value of stock outstanding in the hands of the public by classes and in total;
2. The par or stated value of treasury shares by classes and in total;
3. The sum of the above totals which displays the total issued capital stock, which in most states is the "legal capital" also.
4. Thus it *fails* to show any unrealized capital surplus for the difference between the cost and par or stated value which may or may not be realized depending upon whether the shares are later resold or canceled, and
5. It shows the cost of treasury shares and, by implication at least, designates the amount by which the surplus accounts are restricted as to the payment of dividends or for the purchase of additional shares.

It has been said that under the Illinois law the cost of treasury shares *must* be deducted from earned surplus on the balance sheet. As I was one of the original exponents of the idea I am not embarrassed or reluctant to now state that this is incorrect. Deducting the cost of the treasury shares from capital implies a reduction of capital and therefore deducting it from earned surplus alone likewise implies a reduction of earned surplus. However, it is not a *reduction*—it is a *restriction*, because surplus *may be restored to normal* at any time by either cancellation or resale. The ownership of treasury shares purchased subsequent to the passage of the Act in Illinois *restricts* the earned surplus available for dividends or for the purchase of further shares by the cost of the shares owned, but it does not *reduce* earned surplus because that would ignore the fundamental principle that a surplus distribution must be pro-rata to all stockholders. Furthermore, if deducted from surplus instead of combined capital and surplus, comparative balance sheets between years could show violent fluctuations of surplus which had nothing to do with earnings but which would be caused by the purchase or resale of treasury shares.

The above facts appear to some to warrant the conclusion that treasury shares may be shown on the balance sheet in one of three ways—

(a) As an asset, if resale is certain,
(b) As a deduction from capital stock, if cancellation is fairly certain, and
(c) As a deduction from the sum of capital stock and surplus, if disposition is uncertain.

There is one point in connection with the Illinois Business Corporation Act which is subject to violent differences of opinion between lawyers and accountants. Section 41 (b) of the Act reads;

> Dividends may be paid out of paid-in surplus or surplus arising from the surrender to the corporation of any of its shares only upon shares having a preferential right to receive dividends...

Accountants contend that by this wording deficits arising from operations cannot be charged to paid-in surplus because in affect it transfers paid-in surplus to earned surplus and thus, at a later date when earnings are restored, leaves a balance of paid-in surplus in the earned-surplus account which thereupon becomes available for dividends to common stockholders. Certain lawyers did not agree with that contention, and an amendment was put through which reads as follows:

> A corporation may, by resolution of its Board of Directors, apply any part or all of its paid in surplus to the reduction of elimination of any deficit arising from operations or other losses or from diminution in value of its assets.

It is my own opinion that the law now contradicts itself. One member of the Bar Association's Committee and I, who have worked together off and on for a number of years have always been able to finally arrive at some agreement but we have never agreed, or even came close to an agreement, on this particular point.

PROPOSED FEDERAL CORPORATION OR LICENSING ACT

As you probably know, there has been much activity in Washington lately in regard to proposed legislation to regulate, or to tax, or to license, or to incorporate business

enterprises including public utilities. Some of this agitation and activity has been in the form of bills introduced and some in the form of recommendations by the Federal Trade Commission. To date I think the activities may be summarized as follows:

1. S. 579 was a bill introduced by Senator Borah relative to licensing of corporations engaged in interstate commerce, and was cited as "Corporation Licensing Act of 1935."
2. H.R. 5423 and S. 1725 were substantially identical bills simultaneously introduced in both branches of Congress to provide for the control and elimination of public-utility holding companies. H.R. 5423 was introduced by Mr. Rayburn and is cited as the "Public Utility Act of 1935." S. 1725 was introduced by Mr. Wheeler and is to amend the Federal Water Power Act. Senator Wheeler also prepared a mimeograph statement on his "Public Utility Holding Company Bill."
3. Reports of the Federal Trade Commission have compiled proposals and views for and against Federal incorporation or licensing of corporations and have compiled state constitutional, statutory, and case law concerning corporations, with particular attention to public-utility holding companies and operating companies. These include report No. 69-A, and release No. 250 on January 25th, and release No. 251 on January 28th.

Some of the Federal Trade Commission's recommendations which concern accounting or accountants directly may be summarized as follows:

1. Capitalization of stock and bond discount to be unlawful.
2. To prevent performance for operating companies by members of affiliates of the holding group, of annual auditing which should be performed by outside impartial independents.
3. Complete periodical financial reports to be filed showing results of contracts involving fees for construction, engineering or financial services (which contracts, according to other recommendations should be approved by the regulatory body, but the fees not to be more than the lower of cost or open market rates).
4. To prohibit the inclusion of stock dividends in income or surplus.
5. To prohibit the payment of dividends, in stock or cash, out of funds which do not represent actual earnings (including interest) from operations, specifically excluding so-called intercompany profits as earnings.
6. Provide for proper labeling and designation of each issue of securities and a definite statement of its priorities and subordinations to other issues.
7. Provide that any monies collected for any specific purpose shall be set aside into a fund properly designated, which shall be a trust fund for such purpose.
8. Stock having no-par value to be prohibited.
9. Certain limitations on the issue of preferential rights or lien securities by holding companies.

In Federal Trade Commission Public Utility Releases No. 250 and No. 251 dated January 25, and January 28, 1935, respectively, we find the following which contains a suggestion as to uniform accounting and proper allowance for reserves and depreciation, viz.:

> Relative to Federal jurisdiction in the matter of Federal licensing, the Commission says there is ample precedent for Congress to Act, and it expresses the opinion that a compulsory Federal licensing act and an added permissive Federal incorporation act would provide a reasonable effective solution of the problem. The Commission suggests that the basic provisions for the granting of Federal licenses should be prescribed by Congress and should include desired remedial provisions of a general nature with an administrative body to set up the details of administration and regulation under such general provisions. In addition to its right to grant, suspend and revoke licenses, the Commission suggests that such Federal licensing agency should also be granted full and general powers of investigation and examination. This should include not only the books and records of corporations subject to the licensing act, but so far as pertinent, records of other corporations with which such licensed corpora-

tions had dealings as to relevant matters. The Commission further suggest that such licensing agency should be granted power to make and enforce regulations as to uniform accounting and proper allowances for reserves, depreciation, etc.

We find also the following:

FEDERAL LICENSING AND FEDERAL INCORPORATION

Discussing Federal licensing and Federal incorporation, the Commission says it may be advisable and necessary to enact a compulsory Federal licensing act, which may or may not be supplemented by a permissible Federal incorporation law. Desired conformity can then be made a condition precedent to the granting or continuation of a license. The Commission adds that this logically requires that some administrative agency or agencies be charged with the enforcement of such statutes.

The Commission observes that a number of licensing statutes have passed the constitutional test, and that Federal licensing would avoid dual Federal and state corporate systems.

Under the terms of a licensing act, if enacted, the Commission recommends that it be made unlawful for any utility corporation or holding company to engage in interstate commerce until it obtains a license from the proper Federal licensing body, and licenses be not granted to engage in interstate commerce until compliance with the licensing act and regulations set up under it shall have been determined by the licensing commission. Such legislation, says the Commission, though general, must be definitely comprehensive, and set a standard for administrative action. The Commission advises that the appropriate Federal agency should be granted full and general powers of investigation and examination in aid of the administration and enforcement of such statutes as may be enacted. The Commission also recommends that the appropriate agency be granted power to make and enforce regulations as to uniform accounting, providing for proper allowances for reserves, depreciations, etc. Basic provisions for the granting of Federal licenses, says the Commission, should be prescribed by Congress and should include the desired remedial provisions of a general nature, with an administrative body to set up the details of administration and regulation under such general provisions.

If the licensing method is adopted, the Commission recommends that Congress "legislate to the full extent of Federal jurisdiction in declaring unlawful the various classes of evil practices disclosed by this investigation as to electric and gas utilities and their holding companies, and require their determination as a condition precedent for obtaining and retaining a Federal license to engage in interstate commerce."

Suggesting that such legislation may, by appropriate provisions, be "tied into" the inhibitory legislation already discussed, the Commission says it might include the following as the basis for administrative regulation:

25. Prohibit transportation and sale in interstate commerce of electric energy and gas, or the issue of securities for their sale and transportation, by any utility holding or operating company unless a Federal license is first obtained.

26. Forbid the licensing of any corporation whose charter contains a general grant of power, or so-called "blanket clause," unless such corporation agrees in writing not to use such grant of power.

27. Prohibit any future consolidation or merger of ownership by the holding companies or their operating subsidiaries subject to Federal jurisdiction, without prior approval by the duly authorized Federal licensing agency.

28. Require that each corporation which owns or proposes to buy stock or evidence of long term indebtedness of such an operating utility for any purpose of control, shall have such acquisition approved by the Federal licensing agency.

29. Forbid any holding company or operating utility within Federal jurisdiction to adopt as the value of its stock or physical properties, an amount based upon the selling price of such stock or physical property, when the same parties are represented among both buyers and sellers thereof, without having first obtained the approval of the Federal agency authorized to consider the value of such stock or properties.

30. Prohibit the issue of securities or their sale in interstate commerce by a regulated corporation unless the issuing corporation shall have given full publicity in such manner as the appropriate Federal agency shall direct as to all capital issues, liabilities, capital, investment, gross and net earnings, surplus, and the ownership interests of all officers and directors.

31. Require approval by the licensing agency of all stock and securities, bonuses to officers, directors, and employees, or any holding company or operating company within Federal jurisdiction.

32. Provide that any corporation exercising control over the acts or policies of such a utility corporation shall be deemed to be in the same business as the corporation thus controlled, and subject to all laws and regulations applicable to

said controlled corporation as fully as the corporation itself.

Senate Bill S. 579 in the Senate January 10, 1935, and called "Corporation licensing Act of 1935" contains some sections of interest to accountants. This bill is "to provide for the licensing of corporations engaged in interstate or foreign commerce, and for other purposes," and section 5 (a) reads as follows:

Sec. 5(a) Each corporation which obtains a license under this Act shall make an annual report to the Commission, certified it required by the rules and regulations of the Commission by independent public accountants, which shall contain such information with respect to the organization, capitalization, properties, earnings profits, dividends, and business methods of the corporation, as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. Each such corporation shall also make such special reports, similarly certified, as the Commission shall from time to time require for the purpose of keeping itself informed with respect to the operations of the corporation, and in the event that any such corporation shall increase its capital or issue any bonds, notes, debentures, or similar obligations it shall submit a statement with respect thereto to the Commission. The Commission may prescribe, in regard to reports and statements made pursuant to this section, the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earning statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and non-recurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the corporation, or any person under direct or indirect common control with the corporation; but in the case of the reports and statements of any corporation whose methods of accounting are prescribed, or whose securities are registered, under the provisions of any law of the United States, or any rule or regulation thereunder, the rules and regulations of the Commission with respect to such reports and statements shall not be inconsistent with the requirements imposed by such law or rule or regulation in respect of the same subject matter.

In both S. 1725 and H.R. 5423 the following wording is found regarding accountants' reports:

Sec. 13. Every registered holding company shall file with the Commission, and every mutual service company shall file with the Federal Power Commission, such annual, quarterly, and other periodic and special reports, the answers, to such specific questions and the minutes of such directors', stockholders', and other meeting as the respective Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers. Such reports, if required by the rules and regulations of the Commission having jurisdiction thereof, shall be certified by an independent public accountant and shall be made and filed at such time and in such form and detail as such Commission shall prescribe.

Certain recommendations in connection with either a Uniform State Corporation Act or a Federal Corporation Act appeal to some of us as having merit.

1. That any power to credit any surplus account with part of the consideration received for no-par shares, or the automatic credit to surplus for consideration received in excess of par for par shares, be vested in the stockholders and not be automatic nor vested in the board of directors alone.
2. Where shares have a "call" or "redemption price" in an amount which exceeds the amount of total consideration received to date, the corporation should be prohibited from transferring any part of this consideration to surplus. It might even be advisable to require that other surplus, or the first earned surplus accumulated, should be transferred automatically to capital sufficient to equal such "call price."
3. To prohibit a corporation from purchasing its own shares excepting:
   (a) In settlement of debt
   (b) In settlement with dissenting stockholders

(c) To eliminate fractional shares
(d) In conversion or redemption of shares in accordance with articles,
(e) For resale to employees, or
(f) From employees under a repurchase agreement.

4. To require that any repurchased shares, excepting in 3 (e) above be immediately retired from the class of issued shares by appropriate action with the Secretary of State or similar Federal authority.
5. To apply the Institute rule in regard to "Charges to Capital Surplus in any section similar to a reorganization" so that no such charges could be made excepting by action of the stockholders, and to require (as in a reorganization) that any earned surplus must be *first* absorbed.
6. Instead of permitting that payment of dividends out of "net earnings" (i.e., the earnings of a single year regardless of the status of the earned surplus or deficit at the beginning of the year) to stipulate that cash dividends may be paid only out of "earned surplus" or "accumulated earnings." A corporation which became embarrassed by a large deficit accumulated from previous years could resort to (5) above and thereafter "date its earned surplus" on its balance sheet, such surplus to thus be made available for dividends.
7. To require that no dividends, excepting stock dividends, may be paid out of "revaluation" or "appreciation surplus."
8. To require that any surplus arising from consideration received for shares be designated for some special purpose such as the payment of dividends on preferred stock, and to not be permitted to be used for any other purpose. Also when dividend on preferred is paid, to put the recipients on notice of the sources of such dividend.
9. In many states the judgment of the directors as to the value of the consideration received for stock is conclusive in the absence of fraud or wilful over- or undervaluation in the transaction. Some supporting evidence of this value should be required of them. Furthermore, if stock received in such a transaction is returned to the corporation as donated stock for resale or is sold to the corporation at any lower price than charged by it to the property account, that amount previously charged to the property account should be required to be credited to it. In any event it should not be considered as surplus of a higher rank than "Revaluation Surplus."
10. If necessary to define earned surplus, to use wording similar to that of the Illinois Act. This is a definition by the process of elimination in order to avoid the pitfalls of a direct definition.
11. That each corporation be required to submit annually to its stockholders, 20 days in advance of its annual stockholders' meeting, a balance sheet, profit and loss statement, and an analysis of the changes in the surplus and reserve accounts for the preceding fiscal year. That such statement contain the certificate of an independent public or independent certified public accountant, and be prepared in accordance with standard accounting practise, and be complete as to all significant matters. That while the report to the stockholders may be condensed, it shall refer to the detail report, and it shall meet with the approval of the public accountants before its publication.
12. To provide that any officer or director who authorizes or votes in favor of any loan or advances (excepting in the ordinary course of business) to an officer or director, shall become personally liable for its repayment; also that such loan or advance must be properly displayed in the next annual report to stockholders.
13. To provide that a corporation shall, in its books and in its published reports, indicate clearly the division of the surplus accounts between surplus arising from earnings and surplus arising from other sources.
14. To prohibit earned surplus of subsidiaries to become earned surplus of the new corporation at its date of merger or

consolidation. It would seen advisable, and certainly consistent, to require that in either a merger or a consolidation no earned surplus of any of the consolidating or merging corporations might be so considered, but require that they resort to (1) above in order to provide surplus for the payment of dividends in the "early years."

15. To define the accountant's status and not leave it in the "agent" class as it is in most state laws. In connection with false reports the "agent" may become liable for all damages caused by any material statement that is false.

LIABILITIES

In the foregoing it has been pointed out that while the field of public accounting service has definitely broadened, and the value of its service has been legally recognized, nevertheless the moral responsibilities are no greater than before. It is also true that the resulting liabilities are not commensurate with the fees which these services command. The so-called "strike suit" so often engineered by the disreputable lawyer, did not show the possibilities of such productive results in boom days as it does now. At some later date these liabilities may be lessened by amendment or by precedent through court decisions. At present the problem is to combat and minimize them and to accept the recognized responsibilities so as to carry on with the job. Some small solace may be gained from the recent words of one of the Commissioners who said, "Directors, officers, underwriters and experts may avoid liability if they can sustain the standard of care and investigation of reasonable persons under the circumstances. In other words, negligence and dishonesty are penalized, as is true in every walk of life." Fortunately, in order to sustain the burden of proof either side will require the expert testimony of outstanding accountants and therefore as the Commissioner said, "negligence and dishonesty" will be penalized, but not until negligence and dishonesty have been determined by qualified members of the profession.

It may be that the suggestions of Dr. Joseph J. Klein of New York should be followed. His suggestions are that each State and National Society create a committee on court testimony to which members of the Society and the public would be privileged to submit cases of alleged accounting negligence or malpractice, and that any member of the Society permitted to appear as an expert on behalf of either party, be expected to study the committee's report prior to accepting the engagement, and be held responsible for "reckless" testimony. Also that outstanding members of the profession should be available adequately to present the truth and thus tend to check, if not utterly discourage, irresponsible testimony.

Another source of solace perhaps is the fact that most state laws have for years contained drastic provisions which might be construed as making the accountant even more broadly liable than some of the new Federal acts have done. In many of them there are sections to the effect that if any officers, directors, employees or *agent* knowingly concurs in making or publishing any written report of the corporation's affairs containing any material statement which is false he shall be liable for all damages caused thereby. It is assumed that an accountant may be construed as an agent, and that being the case it seems to me as a layman that state laws may also produce damages not commensurate with the fees received.

CONCLUSION

These new laws with their drastic liabilities should certainly result in some improvement of work done, and thus will be of great benefit to reputable accounts. Certainly minimum requirements should at least include the following:

1. Assignments should never be placed in the hands of any but the most skilled workmen and a partner of the firm should have direct supervision over every engagement.
2. The average audit report should be an all-purpose report for the benefit of stockholders, officers and directors, credit grantors, and the public as well.

3. The balance sheet should state the basis of valuation of the principal assets and should show major classifications at least to a reasonable extent and with a fair amount of description.
4. Profit-and-loss statements should present a reasonable classification of income, expenses and extraordinary items of either a recurring or nonrecurring nature.
5. The certificate should contain all special qualifications not contained on the face of the exhibits themselves and should contain definite statements concerning any material changes in policy, such as changes in depreciation rates, etc.

In this manner the main exhibits and the certificate may be made fairly complete within themselves as to all significant matters and the remainder of the report may then contain only details, and supplemental, clarifying but relatively unimportant material.

CONVENTION REPORT

American Association of University Instructors in Accounting—Proceedings of the Nineteenth Annual Convention, Chicago

THE NINETEENTH annual convention of the American Association of University Instructors in Accounting was held in the Palmer House, Chicago, Illinois on December 27 and 28, 1934. The program was as follows:

Thursday, December 27, Morning Session

General Topic: Methods of Teaching Accounting.

Papers were read by Geoffrey Carmichael, Indiana University; R. E. Glos, Miami University; C. A. Fryxell, Augustana College; Leo A. Schmidt, Marquette University; J. C. Gibson, University of Wisconsin; L. O. Foster, Western Reserve University; Henry T. Chamberlain, Loyola University; E. C. Davies, Northwestern University; J. B. Taylor, Ohio State University; S. G. Winter, University of Iowa; H. H. Wade, University of Iowa; and J. R. Bartizal, Northwestern University.

Thursday, December 27, Afternoon Session

General Topic: Accounting Research.

Papers were read by: S. H. Nerlove, University of Chicago; E. L. Kohler, Arthur Andersen & Company, Chicago; H. C. Miller, Ohio State University; and Andrew Nelson, St. John's University.

Thursday, December 27, Evening Session.

Annual Dinner: Address by Howard C. Greer, Institute of American Meat Packers, Chicago.

Friday, December 28, Morning Session

General Topic: Roundtable Discussion.

Papers were read by: Robert Payne, Lawrence Scudder and Co.; E. J. Filbey, University of Illinois; and H. S. Noble, University of California. Discussion was led by David Himmelblau, Northwestern University; William J. Luby, Northwestern University; and W. J. Graham, University of Chicago.

Friday, December 28, Afternoon Session

General Topic: Accounting Relationships.

Papers were read by H. F. Taggart, University of Michigan; W. J. Graham, University of Chicago; E. A. Heilman, University of Minnesota; E. L. Theiss, University of Illinois. Discussion was led by W. B. Castenholz, LaSalle Extension University; J. J. Reighard, University of Minnesota; Clem W. Collins, University of Denver; and J. B. Heckert, Ohio State University.

Meeting of the Executive Committee

The annual meeting of the Executive Committee was held at 1 P. M. on December 27 with J. L. Dohr, Columbia University; E. L. Kohler of Arthur Andersen & Company; H. G. Meyer, University of Tennessee; George H. Newlove, University of Texas; H. S. Noble, University of California, L. A.; R. A. Stevenson, University of Minnesota; J. B. Taylor, Ohio State University, and C. F. Schlatter, University of Illinois, present.

The committee first heard a brief preliminary report of finances by the Secretary-Treasurer. E. J. Filbey, H. H. Bailey, and G. E. Lukas, all certified public accountants of Illinois, were appointed as auditors of the Secretary-Treasurer's books for the year. The committee ordered that the report of the auditors be published in the March, 1935 issue of the ACCOUNTING REVIEW.

The Secretary-Treasurer was instructed to consult with E. J. Filbey as to the investments of surplus funds in building and loan notes and stock. It was thought best to leave the funds invested as they are until needed, unless the Secretary and Mr. Filbey decided the surplus should be reinvested.

The Committee voted $350 each to the Editor and the Secretary-Treasurer for their services for the year, Mr. Kohler and Mr. Schlatter not voting.

Meeting adjourned at 2 P. M.

Report of Business Meeting, December 28, 1934.

President Dohr called for reports of Committees.

I. Committee on Constitution and By-Laws—Chairman W. A. Paton said that the committee had nothing to report.

II. REPORT OF MEMBERSHIP COMMITTEE

The Membership Committee was reasonably active during the year 1934. The activity was directed along the following lines:

1. Members of the Committee worked their respective districts for new members and for new subscriptions to the ACCOUNTING REVIEW.
2. The heads of the accounting departments in some of the larger schools were asked to approach the non-members on their staffs.
3. A direct appeal to the members of the Association was made in the December issue of the ACCOUNTING REVIEW.

It is becoming increasingly difficult to find members of the Association who are willing to take an active part in the membership work. A number have served year after year, always obtaining a number of applications. Others have accepted service on the Committee and have remained inactive. Any member who is willing to work as a member of this committee is urged to write to the Secretary-Treasurer and to volunteer his services.

The number of members added to our roll during 1934 is 36, while 14 additional applications took effect on January 1, 1935.

While the number of names dropped during this period was greater than the number added, the membership roll at the end of the year probably was more representative of the profession than in the past. A large number of our non-teaching members have been lost in recent years.

A larger income is necessary to support the work of the Association, particularly to enlarge the ACCOUNTING REVIEW. If the individual members will join with the Membership Committee in actively working for new members, there is every indication that one-hundred new members can be added during 1935.

Membership Committee
Harvey G. Meyer, Chairman

III. Report of the Nominating Committee was next heard—H. T. Scovill presented the report as follows:

TO THE AMERICAN ASSOCIATION OF UNIVERSITY INSTRUCTORS IN ACCOUNTING:

Your Nominating Committee presents as its nominees for officers of the Association for the year 1935, the following:

For President in 1935, Howard S. Noble, University of California, Los Angeles
For Vice-President, 3 years, Clem W. Collins, University of Denver
For Secretary-Treasurer in 1935, C. F. Schlatter, University of Illinois.

It is the understanding of the Committee that Harvey G. Meyer of Tennessee is a hold over Vice-President for one year, and Jacob B. Taylor of Ohio State for two years, and that E. L. Kohler's three year term as Editor of the ACCOUNTING REVIEW does not expire until December 1935.

Respectfully submitted,
(Signed) H. T. SCOVILL, Chairman
F. H. ELWELL
G. H. NEWLOVE
A. H. ROSENKAMPF
W. A. PATON

IV. Election of Officers.—No nominations being made from the floor, it was moved and seconded that the Secretary be instructed to cast a single ballot for the nominees of the Nominating Committee. The motion carried and the ballot was so cast.

V. Retiring President Dohr then asked President-elect Noble to take the chair and to call for any other reports yet to be presented. President Noble took the chair and thanked the members present for the honor conferred upon him.

VI. Committee on Governmental Accounting.—Chairman F. H. Elwell. No report.

VII. Committee on Exchange of Teaching Material.—Chairman J. B. Taylor reported that the material collected had been published during the year in the ACCOUNTING REVIEW.

VIII. REPORT OF THE SECRETARY-TREASURER

Members at close of 1933	523
New members for 1934	33
	556
Members resigned or dropped for non-payment of dues	59
	497
New members for 1935 obtained in 1934	14
Total membership January 1, 1935	511

Although the Association is still losing members, it is encouraging to find that the loss through resignations and drops was only 59 in 1934 as compared to 93 in 1933, and that for 1934 there were 36 new members as compared to but 18 new members in 1933. Further evidence of the good work of the Membership Committee are the 14 additional new memberships for 1935 obtained in 1934.

The increase in the number of subscribers and in income from subscriptions from non-members is also encouraging. The increase in income from this source for 1934 is just over $100 above that of 1933. Also, the deferred income from this source increased by another $100. Income from advertising was increased by nearly $80.

The total expenses, exclusive of compensation voted to the Editor and Secretary-Treasurer, have been decreased by nearly $100. This decrease is offset, however, by an increase of $100 in compensation.

Although the Secretary-Treasurer has used every means, short of legal action, to collect back dues, the losses on bad debts are entirely too large. He is glad to report that the dues receivable outstanding on December 31, 1934 is somewhat less relative to members assessed than on December 31, 1933.

The membership will no doubt be pleased to see from the audit report that the Association has not had to encroach upon surplus to maintain its services and the high quality of the ACCOUNTING REVIEW, but that on the contrary net worth has increased by $65.63.

CHAS. F. SCHLATTER
Secretary-Treasurer

Urbana, Illinois
February 20, 1935

American Association of
University Instructors in Accounting:

We have made a detailed examination of all accounts and records of your Secretary-Treasurer, Professor Charles F. Schlatter, for the year ended December 31, 1934.

We found the records to be accurate, complete, and in good order. We believe that all cash received was duly recorded and deposited in the bank. All disbursements were supported by proper vouchers, and were found to have been made in connection with the regular activities of the Association.

We certify that, in our opinion, the accompanying Balance Sheet and Statement of Income and Expenses correctly set forth, respectively, the financial position of the Association as of December 31, 1934, and the operating results for the year ended on that date.

Respectfully submitted,
(Signed) EDWARD J. FILBEY
H. HEATON BAILY
GAZE E. LUKAS
Certified Public Accountants,
Auditing Committee

AMERICAN ASSOCIATION OF UNIVERSITY INSTRUCTORS IN ACCOUNTING

BALANCE SHEET, DECEMBER 31, 1934

Assets

Cash in bank		$ 838.93
Building and Loan Association notes		800.00
Building and Loan Association paid-up stock		300.00
Dues receivable	$654.00	
Less reserve for bad debts	450.00	204.00
Advertising accounts receivable		98.75
Subscriptions accounts receivable	$ 21.00	
Less reserve for bad debts	7.00	14.00
Accrued interest on investments		52.23
Reprints accounts receivable		5.75
Office equipment		22.00
Total assets		$2,335.66

Liabilities and Net Worth

Accounts payable	$553.56
Unearned dues	88.00
Unearned subscriptions	317.00
Total liabilities	$958.56

Net Worth		
Balance December 31, 1933	$1,311.47	
Collections of accounts written off	8.00	
Net income, 1934	57.63	1,377.10
Total liabilities and net worth		$2,335.66

AMERICAN ASSOCIATION OF UNIVERSITY INSTRUCTORS IN ACCOUNTING

STATEMENT OF INCOME AND EXPENSE FOR THE YEAR ENDED DECEMBER 31, 1934

Income			
Dues		$1,983.00	
Subscriptions		923.30	
Advertising		485.00	
Interest on investments		66.00	
Miscellaneous		.94	
Total income			$3,458.24
Expense			
Accounting Review		$2,018.97	
Stationery and Postage		177.72	
Clerical help		218.40	
Loss on bad debts:			
Dues	$360.00		
Subscriptions	7.00	367.00	
Auditing fees		16.95	
Compensation (Editor and Secretary)		600.00	
Exchange and check tax		1.67	
Total expense			3,400.61
Net Income			$57.63

THE ACCOUNTING EXCHANGE

The Development of Accounting Principles

The editorial in the December issue of the Accounting Review is entirely right in pointing out the importance at this time of a better development of accounting principles. Everybody engaged in accounting work, whether in teaching or practice, has the feeling that this is a crucial era for the profession and all its adherents. The fact that we are, as everybody hopes, on the eve of another great expansion of business activity, makes it urgently desirable that business take every step which may help to make the next period of prosperity healthier and more permanent than the last one. The work of the Securities and Exchange Commission is bound to have a vital influence in defining and giving effect to accounting principles. For the first time a government body is charged with the responsibility for prescribing accounting rules for large numbers of business concerns, not from the point of view of raising taxes, nor of rate regulation, nor of any other specific governmental purpose, but from the point of view of business itself and all its participants. It seems to be assumed that either accountants must speedily write their own principles in pretty definite terms, or the Commission will write them for us.

But when the editorial referred to uses this situation as a stick with which to beat the accounting profession, chides it for its tardiness and reluctance to submit itself to a prescribed discipline, and proposes that we as academic men should show the profession how to do it, I cannot but feel that serious damage is likely to be done to the cause we all have at heart. Apparently it is implied that we instructors are more detached, more disinterested, and more courageous, if indeed not more intellectual than the practitioners. Insofar as this means that our experience is limited to certain narrow areas, or that we are innocent of practical contact with these problems as they present themselves in typical companies, or that we are exempt from the contingent financial liabilities which actual practice entails, these are not qualifications but disadvantages. Where university accounting instructors have had considerable practical experience they are eminently qualified to make contributions of the sort invited, but in that case they are likely to sympathize with the difficulties of the profession. In other words the objective can be most satisfactorily reached by a combination of the teaching and the practicing sides of the profession.

I do not imagine that the editor will take very strong exception to this proposition, since he is himself an example of a man who combines in his own person distinguished service on both sides of the question. Nor do I think that the accounting profession is averse to accepting the coöperation of teachers of accounting, provided the latter are willing to go to the trouble of acquainting themselves thoroughly with the problems in hand. I am writing this note, therefore, not with the thought of making any immediate contribution to the principles of accounting, but rather of discussing the attitude and spirit in which the best principles are likely to be evolved.

It is easy to lay down principles of accounting in stricter terms than those hitherto used, but in order that they may be more generally adhered to, they must be flexible enough to accommodate all the varied conditions to be found in actual business life. The same difficulty constantly confronts the teacher of accounting; the temptation is ever present to over-simplify the subject, to reduce it to rigid mechanical rules, and to earn a superficial appreciation from students by giving them something having the appearance of a definite and concrete subject matter, but which they will later find to be a delusion. The principles of accounting are like the principles of jurisprudence. The latter do not consist exclusively, or even primarily, in a set of police rules forbidding us to drink certain beverages, or to drink at certain hours, or to cross the street at the wrong place; they must necessarily go

farther back, and be determined by their ability to bring to a free people the fullest enjoyment of its life and activities. In the same way the principles of accounting should not shackle business with a lot of petty rules, but should form part of an ordered stage upon which legitimate business may carry on its activities with the greatest freedom and hope of accomplishment. Hasty attempts to draw up a complete set of accounting principles represent no gain when they result in rigid rules which will have to be revised or discarded.

The circumstances which make it impossible to give to the principles of accounting the same categorical quality as is found in the data of arithmetic or engineering are well known. They may be summed up under three main headings: (1) the variability of management—the human element in business; (2) the progress of invention and change of fashion, which may upset the best of plans; (3) general economic and political movements, in which individual business men or companies may find themselves helplessly swept along. Any principles of accounting worthy of the name must not only allow the business applying them to take cognizance of all these conditions, but should actually encourage it to do so. It is not a sign of weakness or timidity to consider these variables, but rather a sign of practical wisdom.

One may refer for example to the major problems of income determination and the separation of capital items from income items. The bare statement of these principles is simplicity itself; any first-year student can do it satisfactorily. But to go further, and to write definitions which will in any given case determine which are capital items and which income items, or what are the profits, is a far different thing, requiring extensive acquaintance with all the circumstances of that case, including all the variables which have been mentioned above. To go still further and to write a set of rules which will do the same thing for all circumstances is practically impossible. As in all such attempts, the more territory one attempts to cover in the definition, the more general and guarded must be its terms. This is not because one is afraid to be specific but because it is inaccurate to be so. The resources arising from capital origins, and those arising from revenue origins, in fact mingle with each other to the point of becoming indistinguishable, and it becomes necessary to adapt to each case the rules or conventions in a manner which in that case will arrive at the best results.

It is presumably for reasons such as this that the Securities and Exchange Commission, in its new accounting regulations contained in Form 10 and Form A-2, has to a great extent avoided prescribing definite rules and methods, but *has* prescribed a very full and complete disclosure of whatever methods or rules the company may be following with respect to the several items. The editorial mentioned appeals to these regulations as favoring the development of more definite accounting principles, and in a sense this is true. But a careful study of the Commission's regulations will show that very few rigid rules are to be found in them. There is every appearance that the Commission will insist upon a full and accurate disclosure by the company of what has been done, and, in the case of auditors' certificates, upon a more precise expression of the auditors' opinion upon exceptions and qualifications, but that a good deal of latitude will be allowed individual companies to deal with the circumstances of their own business as the judgment of the management may suggest.

The editor is entirely right in his primary contention. This matter cannot stand still. The principles, practices, and literature of accounting must be advanced and developed to the point of being more definite, more helpful, to all the interested parties. But this will not be furthered by setting teachers and practitioners in opposing camps, but rather by friendly coöperation between the two. And it will not be helped by writing rigid rules too soon.

T. H. Sanders

[Professor Sanders, himself a member of a small group of technicians which is aiding the Securities and Exchange Commission in the drafting of its

forms and regulations, modestly disclaims that the intent of the Commission is to devise principles of accounting, yet he does admit the far-reaching effect that the forms and regulations will have on accounting practice. Since the issuance of Form 10 a month ago, many corporate reports have made their appearance in which the minimum requirements of the regulations accompanying Form 10 have been carefully observed. In the December ACCOUNTING REVIEW the Editor berated the profession for its failure to enunciate standards of procedure; he quoted a report of a professional committee on "principles" which seemed to fall far short of anything so fundamental as principles. The fact remains that the Securities and Exchange Commission in one month has set effective and, on the whole, reasonable standards—necessarily incomplete, of course—for the profession, which years of futile committee work within the professional societies have not been able to produce or even begin to produce. The Editor reiterates his conviction that professional standards should originate from within rather than from without; that accounting fails to measure up to the requirements of a profession if its practitioners must follow blindly rules which others lay down for them. In this conviction the Editor feels that he does not stand alone among his professional brethren, notwithstanding the unfortunate attitude of societies of practitioners; his appeal, addressed to the members of this association—many of whom are practitioners of broad experience as well as teachers—still stands. There can be little justifiable fear that whatever standards that may be devised by accounting instructors will be devoid of practical judgments nor that any of them would tend to devise rules too rigid for general application; there are too many able practitioners among them. But procedural standards (a discussion of what ought to be included under this heading will follow in the next issue of the REVIEW) are coming—to some extent have come. The profession will have much to regret if its standards originate with persons less able than Professor Sanders. The implications referred to in the second sentence of his second paragraph fit Professor Sanders well.—Ed.]

ACCOUNTING TREATMENT OF THE BOND SINKING FUND AND RESERVE

The purpose of this article is to review briefly the accounting treatment of the bond sinking fund and its reserve in their relation to current corporate financial policy. The writer does not intend to discuss the bookkeeping technique involved as such. Most studies on accounting theory review, at least briefly, the entries necessary to record the creation of the fund and the accompanying reservation of surplus. It is intended here, rather, to raise certain questions concerning the background of financial policy and procedure out of which this technique arises.

Instruction in accounting procedure should be sufficiently realistic to convey to the student an accurate, if brief, knowledge of the nature of the business transactions involved. This is particularly important in view of the fact that the "Principles" course usually serves as a starting point for the study of the several fields of business administration. The scope of this course is necessarily limited. It cannot be expected to cover, for instance, the entire field of corporation finance just because it devotes several lectures to the accounting peculiarities of the corporation. On the other hand, it must be remembered that bookkeeping entries presuppose originating transactions. Consequently, although the students' attention is directed primarily to problems of technique, it is to be expected that they learn, at least by inference, something of what goes on in the world of business. It is evident that these inferences should be correct. Thus with reference to the specific problems of the sinking fund and its reserve, the usual textbook treatment should be supplemented by (1) a brief discussion of current bond redemption practice and (2) a more careful analysis of the purpose of the reserve.

The majority of bond issues today require some form of redemption plan which will take care of all or a part of the issue. These redemption provisions are commonly thought of as "sinking funds," mainly for historical reason. This use of the term, however, is, more often than not, misleading. The practical use of the term differs greatly from the theoretical. Too frequently, our discussions of the fund fail to recognize this distinction. Sinking fund entries, as commonly taught, are based on the theoretical

concept. Webster defines the fund as "the aggregate of sums of money set apart to accumulate at interest usually for the purpose of extinguishing a debt, as of a nation, municipality, or company." On reading much of the accounting literature on the subject, one receives the impression that corporations actually invest money periodically (through a trustee) in marketable securities and then years later sell these securities and use the proceeds to redeem their bonds. Some writers, it is true, indicate that there are alternate methods of providing for bond retirement but too frequently the reader is allowed to infer that the above definition is typical.

Still emphasizing the theoretical concept of the fund, the student faces a problem in "actuarial science" or accounting mathematics—that of calculating the amount of the annual payment to the fund. Here he learns a formula or two and again infers something concerning business practice. He may occasionally wonder how it is possible to assume a rate of interest that will be effective over such a long period, but not much is said on this point. Not that a knowledge of the theory of interest accumulation isn't of some value, but the student should not be misinformed concerning retirement procedure.

Modern bond indentures do not generally require a real sinking fund. Rather, they provide for a periodic retirement of a portion of the issue either through the use of serial bonds or outright purchase in the market or purchase by lot. The student of corporate financial practice will, of course, find some instances of actual sinking funds, but today they are not typical. The typical "sinking fund provision" does not provide for a fund but for periodic retirement.

Now in turning to the question of the sinking fund reserve we are dealing with a different type of problem. We concern ourselves with the significance of the surplus account in its relation to a particular problem in business management namely, the determination of dividend policy. In view of the practical unimportance of the sinking fund it would seem unnecessary to give consideration to the reserve. However, sinec the reserve is considered a necessary supplement to the fund and since this apparent necessity is related to the dividend question it seems necessary to inquire whether the reserve is a really effective device for carrying out its intended purpose. The writer believes that the present-day emphasis on the surplus account in accounting literature results in students overlooking a very important factor in financial management—working capital position. The sinking fund reserve is only one of a number of surplus reserves. All have the same purpose. Consequently the following analysis of the purpose of the one reserve is really applicable to the others, and it is hoped that this analysis will show the necessity for a closer attention on the part of students to the relation between dividends and cash balances.

The customary textbook treatment of the sinking fund reserve fails to analyze clearly the purpose of reserving surplus; where an explanation is given, it frequently implies certain doubtful assumptions.[1] Some bond indentures require that the "sinking fund" be accumulated "out of profits"—a somewhat ambiguous requirement. In such cases a reserve may be necessary. However, much of our literature on the subject conveys the impression that the reserve is inherently necessary regardless of this requirement. In the few cases where a reason is given for this apparent necessity, it is generally to the effect that "it (the reserve) attempts to insure that the decrease in working capital caused by contributions to the sinking fund be restored by profitable operations before any dividends can be paid from the current year's profit." This statement would be sufficiently accurate were it not for the fact that it assumes too much concerning the purpose of the surplus account. It assumes (1) that the stockholders look on the surplus account as a measure of the dividends they shall receive in the near future and (2) that the directors themselves use the same measure in setting dividend

[1] A noteworthy exception to this statement is Finney's Volume I, *Principles of Accounting.*

disbursements. Needless to say, both of these assumptions are far from true.

As to the first assumption, it hardly seems probable that today stockholders expect complete distribution of surplus or of current earnings. It is common knowledge that one of the guiding principles in present-day financial management is that of corporate saving—increasing the investment in the enterprise through the accumulation of profits. The surplus account is a legal measure of allowable dividends and a study of it is useful in analyzing the progress of the business but its present function most certainly is not to show the amount of dividends that will now (or ever) be paid. Referring to the second assumption, it is equally obvious that surplus and current earnings do not control exclusively the size of dividends. A very important if not a major factor in the formation of dividend policy is the amount of available cash on hand. This in turn is largely a function of working capital requirements. Presumably, the directors, assembled to settle the amount of the next dividend, have one eye on the cash balance and the other on the future cash requirements and are not unmindful of the fact that a contribution must be made shortly to the sinking fund trustee. In other words, practically, the cash statement and not the surplus account is the principal determinant of dividend policy. Thus, since neither the stockholders nor the directors look upon the surplus account as the sole measure of the size of the dividend, it seems that the creation of a surplus reserve to protect the sinking fund is at best but a futile gesture.

In order to demonstrate more clearly the futility of the reserve, a number of hypothetical balance sheets will now be produced showing different stages in the life of a fixed debt—burdened corporation. The corporation's balance sheet is presented first as of January 2, 1930.

(First stage)
Balance Sheet
January 2, 1930

Cash	50,000
Other Assets	1,000,000
Total Assets	1,050,000
Liabilities	400,000
Net Worth:	
Capital	400,000
Surplus	250,000

On January 3, 1930, the corporation borrows $1,000,000 through the sale of twenty-year bonds at par. A sinking fund is to be created which, ignoring interest accumulation, will require twenty payments of $50,000 cash. It is assumed that (1) the corporation requires $50,000 cash as working capital, (2) profits each year equal $50,000 and are reflected in the balance sheet by increases in cash, and (3) the proceeds of the bond issue are immediately invested in "other assets."

(Second stage)
The Bonds are Sold
Balance Sheet
January 5, 1930

Cash	50,000
Other Assets	2,000,000
Total Assets	2,050,000
Liabilities	1,400,000
Net Worth:	
Capital	400,000
Surplus	250,000

(Third stage)
profit is Shown for 1930
Balance Sheet
December 31, 1930

Cash	100,000
Other Assets	2,000,000
Total Assets	2,100,000
Liabilities	1,400,000
Net Worth:	
Capital	400,000
Surplus	300,000

(Fourth stage—same date)
Sinking Fund is Started with $50,000 Deposit
Balance Sheet
December 31, 1930

Cash	50,000
Sinking Fund	50,000
Other Assets	2,000,000
Total Assets	2,100,000
Liabilities	1,400,000

Net Worth:	
Capital	400,000
Surplus	300,000

Judging by the surplus account the corporation is now in a position to distribute $300,000 to stockholders but obviously no distribution can be made without impairing the working capital. However, the firm's accountant recommends the setting up of a reserve for the fund thus limiting possible dividends to the amount of the original surplus of $250,000!

(Fifth stage—same date)
A Reserve of $50,000 is Set Up
Balance Sheet
December 31, 1930

Cash	50,000
Sinking Fund	50,000
Other Assets	2,000,000
Total Assets	2,100,000
Liabilities	1,400,000
Net Worth:	
Capital	400,000
Surplus	250,000
Reserve	50,000

(Sixth stage)
Twenty years later
The sinking fund has received the last deposit.
No dividends have been paid throughout the period.
Balance Sheet
December 31, 1949

Cash	50,000
Sinking Fund	1,000,000
Other Assets	2,000,000
Total Assets	3,050,000
Liabilities	1,400,000
Net Worth:	
Capital	400,000
Surplus	250,000
Reserve	1,000,000

(Seventh stage)
The Bond Issue Matures
Balance Sheet
January 2, 1950

Cash	50,000
Other Assets	2,000,000
Total Assets	2,050,000
Liabilities	400,000
Net Worth:	
Capital	400,000
Surplus	250,000
Reserve	1,000,000

The final stage, the directors face a dilemna. What shall they do with the reserve? It would scarcely be correct to leave it on the books as "Sinking Fund Reserve" when there is no longer a fund. Shall the directors then change the name of the account to, say, "Reserve to Limit Dividends to $250,000," or, should the account be returned to Surplus to permit a dividend of $1,250,000?

The foregoing illustration has been worked out at some length in order to show clearly that the sinking fund reserve serves no real purpose. If, on the other hand, the surplus account were made to show the real intention of the directors regarding dividends, then this reserve, supplemented by other reservations of surplus, would have real significance. Such is not the case today, however. The writer hopes that the above illustration will also serve in changing the approach to the dividend question. Less emphasis on surplus and greater attention to the significance of working capital will result in a more realistic concept of this problem in financial management.

In concluding, the writer wishes to emphasize two points: First, a study of accounting theory necessarily is related to business practice. Students draw inferences concerning it even though they are directly concerned with theoretical concepts and with problems of recording technique. Since the study of accounting serves as an introduction to the study of corporation finance, business administration and allied fields, it is vital that students acquire a correct background. Finally, the study of corporation accounting respecting dividend policy has over-emphasized the surplus approach and consequently has resulted in students acquiring a too legal viewpoint. More attention should be given the financial aspect of the problem.

Sterling K. Atkinson

ERRATA

Through unfortunate typographical errors in the December issue of the REVIEW, Elmer Hartzell's article, *Profits in the Steel Industry,* became considerably garbled. The following corrections should be noted:

(1) In the last line of the first column on page 328, "change offs" should read "charge offs."

(2) In the third line of the first column above the table on page 329 these words should be inserted after "1929" and before the parenthesis: "is taken to be broadly proportionate to that of 1910."

(3) Table V on page 331 should be labeled "Table VI."

(4) The reference to "Table V" at the end of the first paragrah of the second column on page 332 should read "Table VI."

(5) Table V was lost somewhere between the author and the reader. It is reproduced here below.

TABLE V

TWO-YEAR AVERAGE EARNINGS OF STEEL COMPANIES AS A PERCENTAGE OF TOTAL ASSETS

Period	U. S. Steel		Bethlehem Steel	Youngstown Sheet and Tube	Republic Iron and Steel	Crucible Steel	Wheeling Steel	Inland Steel	Colorado Fuel and Iron	Central Alloy Steel	Otis Steel	Donner Steel	Gulf States Steel
	Based on revised data	Based on unrevised data											
1905–06	14.0%	8.3%	4.7%	—%	3.2%	4.9%	—%	—%	2.5%	—%	—%	—%	—%
1907–08	11.1	6.1	4.0	—	4.4	2.4	—	—	2.6	—	—	—	—
1909–10	10.6	3.4	4.3	—	2.6	5.1	—	10.5	4.2	—	—	—	—
1911–12	7.6	4.3	5.8	—	2.4	5.4	—	10.5	5.8	—	—	—	—
1913–14	7.0	4.2	8.3	—	3.1	5.2	—	9.8	2.6	—	—	—	—
1915–16	13.8	10.3	18.4	—	11.1	10.8	—	23.1	3.3	—	—	—	11.6
1917–18	10.8	8.0	7.9	—	18.5	14.0	—	27.5	5.5	12.4	—	6.7	11.2
1919–20	7.0	5.1	6.3	—	5.9	8.8	—	15.1	2.8	10.6	7.1	2.4	2.8
1921–22	4.4	2.9	4.2	2.9	0.6	2.7	0	1.8	0.7	1.6	0	0	2.0
1923–24	6.5	5.2	4.0	8.4	4.4	4.2	4.0	9.2	2.9	4.6	4.3	4.9	6.3
1925–26	6.9	5.2	5.0	11.0	4.7	4.8	6.2	8.7	5.2	7.1	6.7	5.5	4.6
1927–28	6.4	5.2	3.4	6.9	4.0	4.8	6.2	11.3	4.4	6.9	8.6	5.8	4.2
1929–30	7.6	6.4	5.5	7.9	—	5.3	5.8	11.8	3.7	—	7.9	—	2.7

Note: Earnings represent the balance available for fixed charges or dividends, after the deduction of depreciation and depletion.

The companies are listed from left to right according to their size in 1930, as measured by their total assets. With the exception of the Colorado Fuel and Iron Company there was no wide departure from the ranking throughout the entire period. Average total assets of the companies in 1929 and 1930 were: U. S. Steel $2,139 millions (revised data); U. S. Steel, $2,394 millions (unrevised data); Bethlehem Steel, $720 millions; Youngstown Sheet and Tube, $258 millions; Republic Iron & Steel, $162 millions; Crucible Steel, $123 millions; Wheeling Steel, $125 millions; Inland Steel, $103 millions; Colorado Fuel & Iron, $78 millions; Central Alloy Steel, $75 millions; Otis Steel, $40 millions; Donner Steel $32 millions; and Gulf States Steel, $32 millions.

BOOK REVIEWS

Concentration of Banking. John M. Chapman. (New York: Columbia University Press, 1934. Pp. xi, 288. $5.00.)

Dr. Chapman explains, in the Preface, that "This book is intended to deal with the various changes in the field of banking—and to attempt to evaluate them." The changes include the growth of branch banking, bank mergers and consolidations, the large increase in the average size of the unit bank, the growth of chain banking and the more recent appearance, group banking. In the preparation of the volume, the author had the singular advantage of an investigation, under Professor H. Parker Willis, of bank failures and branch banking. The data taken from that work, sponsored by California bankers, has been brought down from 1924 to 1929 by the author himself and from 1929 to 1931 as a result of his participation in the study by Professor Willis which resulted in the recent publication, *The Present Banking Situation.*

"One of the fundamental changes which has been taking place has been the concentration movement" and this has worked changes in the unit banking, a system which "—has failed to meet the acid test." Moreover, the opposition to branch banking, an important phase of concentration, "—is crumbling." But, unless "—branch banking is legalized in many states, we shall see in the near future another rapid increase in the formation of chains or groups." Such a development would be most unfortunate in the opinion of the author, but one must choose branch, group and/or chain banking, for the unit banking system offers no solution of banking problems.

Such is the argument of Dr. Chapman in general terms. This argument is elaborated in following chapters, both statistically and deductively, chiefly the former. The indictment of the unit banking system rests upon several counts. Thus, it has "—demonstrated its inability to provide safe and adequate banking facilities for small communities." Adequate credit investigation cannot be undertaken and for this and other reasons, operating costs are high and earnings low in proportion to capital employed. Hence the small unit bank is always near the margin and the failure rate among unit banks is high. Moreover, the system does not provide banking service of any sort for many small communities.

One is left with the impression that the deficiencies of unit banking are responsible for the growth of mergers and consolidations which attained a relatively high volume by 1919. The causes of this growth are analyzed and about twelve distinct motivating factors are brought out, among which the "—prevention of bank failures—" is outstanding. Unfortunately, Dr. Chapman does not go into the defects of the correspondent system, another of the outstanding factors. However, the desire of banks to obtain branches is a factor well presented. The early branch banking movement in the United States is then discussed, followed by an excellent treatment of branch banking policy from enactment of the National Banking Act down to the Banking Act of 1933. The changing attitudes of Comptrollers of the Currency and of the Federal Reserve Board are, of course, only partial explanation of the failure of branch banking to gain adequate recognition, though real progress was achieved in the Banking Act of 1933.

As for the merits of branch banking under American conditions, California presents the most elaborate experiment from which data can be drawn, a source to which the author turns, and one gains the impression that he approves of the results there. Turning to "The Legal Status of Branch Banking" we find that branches have developed chiefly within limits of the same city of the parent bank and so long as this condition prevails "—we shall not have the type of branch banking that has won much favor in other leading industrial and commercial nations." The McFadden Act was designed to check rather than encourage branch banking, while the Act of 1933, permits state-wide branch banking in those states where state banks may operate branches. But, clearly, the future of branch banking on the part of national banks is placed in the hands of the states of which only seventeen permit state-wide branch banking. Among these he lists Virginia, though the law limits branches to cities of 50,000 and to counties adjoining that in which the parent bank is located, where the branches are the result of merger.

In his study of "The Extent of Branch Banking in the United States" Dr. Chapman finds that "—branch banking, as measured in terms of deposits, was expanding at a more rapid rate than the banking system as a whole." However, branch banking "—in this country is restricted to a very considerable extent to city branch banking," and this growth was much influenced by the Comptroller's ruling of 1922. On the other hand, "The McFadden Amendment (1927) did not "—bring about any very fundamental change in the branch-banking situation." Finally, "Until we have adopted and tried a branch-banking system on a much wider scale, we shall be unable to determine whether such a system will work satisfactorily in this country" for, our system remains "—essentially a unit system with a few large banks operating a considerable number of city branches." Indeed, branches located in Detroit, Los Angeles, New York, Philadelphia and San Francisco, in 1931, account for about 50% of all branches.

In discussing "Branches and the Correspondent System" the author finds that "—the unit bank is only partly independent of the large city correspondent" and since correspondent banks "—are constantly under the observation of the city bankers" the unit system is not so much more inde-

pendent than branch banking as one might suppose. Again, "It is in reality less likely that funds will flow into the central money or stock market under the branch system than under an independent system." This excellent chapter has only one deficiency —it is much too brief.

In taking up "Some Economic Aspects of Branch Banking" Dr. Chapman brings out many significant points. Thus, "There are many places in which a bank with the minimum capital required of a national bank could not succeed for the simple reason that the volume of business is too small—." Yet, these places should have the banking facilities that a branch system could readily afford, for "The funds of the branch may be more economically used and a larger return realized than where the unit bank acts through another bank." And this fact should not result in a larger flow of funds into the stock market than now occurs under the unit banking system and probably not nearly so large. However, there are certain arguments against branch banking, but lack of contact between depositors and senior bank officers who determine policies is the only one that has much force.

The author's treatment of "Branch Banking and the Federal Reserve System" makes it clear that the development of branch banking should work profound changes in that system and his discussion of "Chain Banking" leaves one with the definite impression that those states that prohibit branch banking, while permitting chain banking, have suppressed a relatively desirable for a menacing system of banking. If branch banking were authorized "—the problem (of chain and group banking) would in a large measure be solved." Moreover, a branch system would provide banking facilities for communities where a group organization could not afford to operate. Obviously power and responsibility are much more definitely associated in branch banking than in either chain or group banking and this is sufficient justification for elimination of the latter types and the substitution of the former.

Dr. Chapman regards "—the history and development of branch banking in the United States" as the most important phase of his volume, but definite conclusions concerning "—the result of branch banking cannot be drawn until it is given a trial in this country." Branch banking is clearly the most important phase of concentration in banking, a movement which was markedly stimulated because of bank failures, the desire to establish branches, and the desire to enter the trust business. In any case the high mortality rate among small unit banks emphasizes "—the need for some type of banking reform—."

This reviewer feels grateful to Dr. Chapman for making available a vast amount of statistical and other material essential to the formation of sound impressions concerning branch banking. His conclusions are, for the most part, acceptable and where not so acceptable, difficult to refute. But this reviewer does not share the optimism of the author concerning the future of branch banking, for he concluded his study of this volume with the distinct impression that the antagonism between the state and national unit banking systems, which is chiefly responsible for the various forms of concentration, will continue to work havoc to the cause of sound banking in America.

E. A. Kincaid

University of Virginia

Corporation Financial Statements. Mortimer B. Daniels. (Ann Arbor: University of Michigan Bureau of Business Research, 1934. Pp. vii, 131. $1.00.)

"Corporation Financial Statements" by Mortimer B. Daniels is a critical survey of financial statement practice as exemplified by the annual reports of two hundred ninety-four corporations. The work is carefully and thoughtfully done. Mr. Daniels has shown unusual ability in keeping his work clear, concise and consistent, and has succeeded in packing a surprising amount of accounting theory into a brief volume. The problems of the balance-sheet, the income-sheet and the consolidated statement are presented. The topics selected for extended treatment are: valuation of plant, treatment of various reserves, valuation of investments in foreign subsidiaries, and treatment of the minority interest in consolidated statements. All of these topics are timely and, certainly, the third has received but little attention in recent literature.

The discussion of the valuation of plant involves the vexed question of write-ups and write-downs. It is difficult to do justice to Mr. Daniels in a brief statement, but it seems fair to say that he believes that the plant item should represent unrecovered costs rather than replacement value and that he holds uncompromisingly to this view. In conclusion seven he states: "Write-ups of plant assets and write-downs both result in inaccurate financial statements. When plant assets are carried in the accounts above or below cost less depreciation, expression is given to the misconception that balance-sheets should reflect values. The more important effect of resulting distortion of future income is often overlooked," and he adds in conclusion nine: "Recent write-downs smack of manipulation. As they are being accounted for, not only will future income be overstated, but to the extent that reductions of capital are a concomitant of the write-downs, dividends based on future income will be, in effect, capital distributions." One cannot quarrel with the logic of this view though it may imply an undue faith in the accuracy of estimates of depreciation. Neither can one advocate arbitrary and unreasoned variations of plant valuation. Yet, there are times when business necessity requires that plant values, even though they be unrecovered costs, be brought into harmony with replacement values. In the case of write-downs, the more cur-

rent problem, this usually involves loss to the stockholders, a recognition that a part of the costs never will be recovered. Such an adjustment may be accomplished by a sale of assets or by a reorganization. It would hardly be argued that a dividend declared by the new owners and computed on the basis of the new valuations was a distribution of capital. Is it not reasonable to regard write-downs which reflect prudent business judgment as being in the nature of reorganizations? To say that a revaluation accomplished through a costly court procedure is proper and that the same revaluation reached by agreement is improper would seem to be more the application of rule than of reason. Revaluations should be made by experienced business men familiar with the corporation and with the business situation and they should be advised, or, at least, their proposals should be reviewed and criticized, by trained accountants. It seems likely that in the future all of the parties to business enterprise will place greater dependence on the work of the accountant than they have done in the past. If accountants justify that faith it will be through the application of trained judgment rather than by the application of rules.

To all of those interested in corporation finance and accounting, Mr. Daniels' volume will be most welcome. It should do much to bring about the clarity, adequacy and accuracy of financial statements which he so earnestly advocates.

PEMBROKE H. BROWN

University of Illinois

Expenses and Profits of Variety Chains in 1932. (Boston: Harvard University; Bureau of Business Research. Pp. vi, 30. $1.00.)

This bulletin by the Harvard Bureau of Business Research is a continuation of a previous study of the operating results of Variety Chains. In contrast with the previous bulletin which gave operating results for 1929 and 1931, the present bulletin is based upon a far more adequate sample and consequently the conclusions reached are far more definite and decisive.

Some of the findings brought to light by the study are briefly as follows:

1. As compared with the small chains, those fairly large in both sales volume and number of stores in spite of lower gross margin, made a much better showing with respect to net business profit, because of their lower cost of doing business.
2. In relationship to net sales payroll expense was higher in small cities (17.79%) than in large cities (12.01%). For the same stores tenancy costs were lower in small cities (6.41%) than in large cities (9.00%). Furthermore the smallest concerns whether measured by volume of sales, by number of stores, or by average sales per store, invariably showed the highest average percentage for salaries and wages and the lowest percentage for tenancy costs. This conclusion probably indicates merely the greater economy of operating large size retail units in the variety chain field.
3. Store expenses (25.13%) represent by far the greatest part of expense. Conversely all other expenses (3.13%) including all central office and warehousing expenses are only a small fraction of total expenses.
4. A comparison of year-to-year changes in operating results reveals the following changes:
   a. Since 1928 the aggregate number of stores has increased from year to year.
   b. During the same period average inventory per store and average sales per store have steadily declined.
   c. Aggregate net sales, however, have only slightly declined since 1930. A substantial decline in sales volume has been prevented only through opening many new stores.
5. During the depression, variety chains have been employing advertising in increasing amounts.
6. Taxes, excluding taxes on real estate, were in dollars 40 per cent higher in 1932 than in 1929.
7. Variety chains have weathered the depression far better than many other types of retail enterprises. Even in 1932 the majority of the variety chains earned a profit.
8. A comparison of profitable and unprofitable chains shows that the chief advantage enjoyed by the profitable chains is markedly lower percentages of store expense.

The variety chains have been more successful than most types of retail stores in weathering the depression. In comparison with other types of retail stores which handle similar merchandise, the variety chains operate successfully with a lower mark-up on merchandise and a lower expense ratio. Particularly significant is the relatively small expense of 3.13 per cent of new sales which is chargeable to the central office. Included in the tasks of the central office are the buying of merchandise for the retail store; some warehousing of merchandise; and the planning, supervising, auditing and evaluating of the performances of the various retail outlets.

In exploring the field of chain store operation the Harvard Bureau of Business Research is revealing many facts which are valuable both to the teacher of business and to the business man. It is hoped that the effects of the depression will not curtail the research activities which have been started in this field.

E. H. GAULT

University of Michigan

Federal and State Control of Banking. Thomas J. Anderson, Jr. (New York: The Bankers Publishing Company, 1934. Pp. xiv, 514. $2.50.)

In this volume Mr. Anderson "—has attempted to trace briefly the past problems, controversies, and litigation which have grown out of dual govern-

ment control of banking; to show how this divided control has been vitally related to the recent weaknesses of the banking system, to point out the importance of proper jurisdictional policy—; and to analyze the power of Congress to establish Federal control over all banks of commercial deposit." After outlining "The Problem in its Setting" the author considers, in the second chapter, the two Banks of the United States and finds that Supreme Court decisions established the power of Congress to create banking corporations, and to protect them against the taxing power of the states; also that a dual banking system created important evils. The weaknesses developed by decentralized state control of banking, 1836-63, are brought out and there follows a discussion of the rise, the opposition to and the relative decline of the national banking system, 1863-1913.

Under the topic "The Par Remittance Controversy," Mr. Anderson takes up the rise of the Federal Reserve System and the three significant jurisdictional controversies developed thereunder, the first of which was related to par remittance. The effort of the Federal government, through a Federal agency, to achieve nation-wide par remittance for checks ". . . failed of accomplishment because of our dual system control of banking." In passing to the second "The Fiduciary Controversy" the author begins to rely more fully upon primary sources. Section II (k) (Federal Reserve Act) granted fiduciary powers to national banks under certain conditions and trust companies ". . . immediately questioned the constitutionality . . ." of the powers thus given. These were intended to equalize the competitive position of national and state banks and, after extended litigation, they were affirmed by the courts. But ". . . such attempts to maintain a parity of operating privileges have thus far proved futile and are likely to continue so as long as dual control of banking is permitted." In developing the third phase, "The Controversy over Bank Taxation," Mr. Anderson, after writing an excellent exposition of the problems connected with the taxation of national banks, concludes that "Competition between state and national banks and the fear of Congress that national banks might be placed at a disadvantage in comparison with their competitors by discriminatory state taxation constitute the basic facts which gave rise to the vexing problem of national bank taxation." He leaves the impression that the problem is still unsolved, after numerous court decisions and two Congressional revisions of Section 5219, but he does not think that Congress will relax its restrictions upon taxation of national banks by states.

Chapter VII deals with bank mergers, chain and group banking, bank affiliates and branch banking as aspects of the problem of bank control. The first phase has permitted the development of conditions "—which make effective supervision under dual control impossible." As for the second, a system of unified national control is essential to adequate regulation. Moreover, affiliates cannot be dealt with properly under dual control because state laws may permit what national laws prohibit and conversion from national to state charter would result. Finally, branch bank problems can be solved only by the adoption of a policy which would be impossible with dual control. In discussing bank failures, Mr. Anderson considers amendments liberalizing the National Bank Act and holds that these weakening provisions would not have been enacted had it not been for "—the prior laxity of state legislation." His study of the subject leads him to conclude that "—there is ample justification for bringing all banks which engage in a commercial banking business under—" Federal control and the simplest way of doing this is to require all such banks to take out national charters.

He is thus led to consider the nature and extent of Federal power over banking. After analyzing leading cases he concludes that "—Congress, relying solely on its power to create and maintain a banking system, could put an end to—frustrations of the national purpose—" by requiring all banks doing a commercial deposit business to take out national charters. Then come two chapters on the commerce clause of the constitution and, after careful analysis, Mr. Anderson concludes that "—Congress relying solely upon its powers to regulate interstate commerce, 'May completely dominate the field of commercial banking'." He makes out a strong case supporting this conclusion, but one is left somewhat unconvinced. In discussing "Currency and Other Federal Powers," the author contends that there is a reasonable basis "—for the belief that the phrase 'Regulate the Value' of money could be interpreted as implying, also, the regulation of the purchasing power of money." Hence, unless Congress has under its control bank deposit currency, it cannot adequately regulate purchasing power. In his analysis of the borrowing power of Congress he is disposed to believe that the taxing power might be used to force all state commercial banks into the national system under the authority of the commerce, currency or a combination of powers.

Mr. Anderson's final conclusion is that "—Congress possesses adequate constitutional power to assume exclusive control over all banks with commercial deposits." Lawyers and judges might not agree with his findings, for the various questions considered are highly involved, but they will not deny that he ably analyzed the relevant cases and treatises and presented his conclusions with a convincing clearness. Moreover, he is able to cite much material supporting his own conclusions. Students and teachers of banking will find the volume highly valuable for reference purposes.

E. A. Kincaid

University of Virginia

Higher Control. T. G. Rose. (London: Sir Isaac Pitman & Sons, Ltd., 1934. $3.00.)

The author's aim and objective in this worthwhile book is to portray a method of executive control by means of which danger points in management are automatically brought to attention. Realizing that techniques cannot replace imagination, the inventiveness and leadership of men, it is contended that the method presented can accomplish three things; namely—

1. It can make any business manageable, by making the statistics self-explanatory.

2. It can give every responsible department head a comprehension of how his share affects the total results, as to make sure of the eager team cooperation.

3. And finally, it supplies the only certain way by which those responsible for the final supervision of an undertaking—the owners or directors, as the case may be—can be kept steadily and exactly informed of the progress or retrogression of each of the separate policies the board has instructed the management to pursue.

With these ideas in mind the writer proceeds with enthusiasm and thoroughness to demonstrate his ideas and urge adoption of the techniques presented. His main dependence for figures and data is upon the accounting department, whose figures are suggested as supplying the key to the whole trend of the company's affairs. His approach and treatment are typically accounting rather than engineering. In this connection he exalts the work of accountants, but at the same time points out the weakness in most professional accounting results, from the management point of view. He says, "It may be that at some future date the presentation of accountancy results from the point of view of assisting management will form a recognized part of the professional accountant's training," but for the present this is lacking.

An early chapter entitled "The Basis of Comparison" develops the idea of charts for comparison purposes based on moving annual totals, and this form of presentation is stressed throughout the book, the contention being made that there is no form of statistical return which cannot be expressed by this trend method. A moving annual total is made up by taking the results at the close of the last financial year, and at the end of the following month adding the results for the new month and subtracting the results for the corresponding month of the old year. The trend, of course, indicates the direction of progress, and a check upon desired attainment. He later defines higher control as a monthly survey of the functional activities of a business based upon direct trend comparison between the present and period immediately passed.

The author agrees with and quotes Knoeppel (Profit Engineering, by C. E. Knoeppel) that the primary consideration in operation of a business is to provide for profits. He seems to disagree with the effectiveness of budgeting because it does not directly show whether a firm is doing better or worse than the last financial year. The reader will form his own opinion as to the importance of this feature, in view of the fact that the flexible budget idea does show accomplishment as compared with that planned. Perhaps this is more important. However, the chapters dealing with general finance and distribution do present excellent material helpful in gaining a clear picture of these respective situations and of the business as a unit. The illustrative material is excellent, the explanation adequate and the procedures advocated convincing in their effectiveness. Stress is placed upon the ease and small cost of the methods advocated. Problems are stated, the manner of solution is shown, and the helpfulness of charts clearly portrayed.

The book is commended to accountants because of its emphasis upon the formulation and presentation of data as an aid to executive management. For executives and subordinates a simple technique of executive control is outlined. To bankers, owners, directors and others interested the book serves to indicate ways in which essential facts may and perhaps should be obtained.

Arthur G. Anderson
University of Illinois

Mathematics of Accounting, Revised Edition. A. B. Curtis and J. H. Cooper. (New York: Prentice-Hall, Inc., 1934. Pp. xii, 480. $5.00.)

The following statement is taken from the preface of "Mathematics of Accounting": "The authors have kept two things constantly in mind while preparing this Revised Edition: first, its use as a practical text by the student of accountancy; and second, its use as a handbook of general information by the qualified accountant, either public or private." This purpose, in the opinion of the reviewer, has been amply fulfilled. The contents of the book are very inclusive, covering most of the practical relationships of mathematics to accounting.

Starting with the simplest of problems in addition, subtraction, and division, the authors lead the reader through a comprehensive outline of mathematical accounting problems, reaching the most complex in the latter half of the book, where actuarial mathematics is considered. All subjects are presented in a very concise and logical manner. The reader is ably assisted by examples. In accordance with a mathematical mode of presentation each example is followed by its own set of problems. A great many of the problems have been taken from C.P.A. examinations.

Justly finding their place in a book of this nature are certain problems of a more general scope, such as, Goodwill and Partnerships. These problems are dealt with by means of simple mathematical analysis. Following the discussion of Goodwill is presented the problem of issuing securities in consoli-

dations. In this instance the authors point out that this mathematical analysis is merely a helpful illustration of the principles involved and not a form to be rigorously followed. It is but an indication of the great aid to be had by the application of mathematics to accounting and financial problems.

The book is divided into two parts, the first part dealing with the simpler relationships and practical uses of mathematics in accounting, and the second part dealing with more involved mathematical formulae and their practical applications to accounting. The first portion contains such topics as short methods for the accountant in adding, subtracting, and multiplying; verification of computations by check numbers; fractions; percentage; simple interest, bank discount, and partial payments; progression; fundamentals of algebra; and logarithms. In addition to the above more or less purely mathematical portion of the first part, the mathematics which is involved in the calculation of Goodwill, liquidation of a partnership by instalments, foreign exchange, calculation of the value of stock rights and book value of stock is presented.

The second part of the book takes up compound interest, ordinary annuities, special annuities, bond and bond interest valuation, asset valuation accounts and the various methods of calculating depreciation, and the mathematics involved in the accounting for Building and Loan associations.

There are also three valuable appendices containing: measurements of or pertaining to angles, surfaces, polygons, and circles under the heading "Practical Business Measurements"; tables of weights, measures, and values; and a table of logarithms, compound amount of one, present worth of one, and the amount of annuity of one.

The great variety of both practical and theoretical subjects covered in a mathematical manner makes the authors' work a very valuable textbook, while the clarity and brevity with which this wide range of problems is treated have produced for the accounting practitioner a ready reference work and handbook.

JNO. W. MCMAHAN
University of Illinois

Modern Accounting Systems. William D. Gordon and Jeremiah Lockwood. (New York: John Wiley & Sons, Inc., 1933. Second Edition Largely Rewritten, Pp. vii, 481. $4.00.)

This is a useful type of accounting literature in that it applies the general principles to the conditions of specific lines of business, and shows the main lines of the accounting plan suitable for them. The extent of the revision represented in this second edition may be briefly summarized by saying that, scattered through the whole book there is the equivalent of about five pages of additional text matter, about the same quantity rewritten, mainly in the direction of bringing it down to date, and something like twenty new forms, either added to or substituted for the forms to be found in the first edition. Perhaps the most striking change is in connection with the questions and problems to be found at the end of each part; the former edition contained problems for written work; an entirely new lot of these has been furnished, and in addition a set of questions for discussion has been attached to each part. In spite of the efforts of the authors to be quite modern, it is difficult for any of us to be quite up to date in these swiftly moving times, as witness the remark (page 186) to the effect that the rules of the New York Stock Exchange "establish the procedure to be followed between brokers and between brokers and customers." This of course was before the days of the Securities and Exchange Commission, which is in a fair way to relieve the authorities of individual exchanges of that function.

Readers of the first edition will remember that the authors have written a book dealing with bookkeeping procedure. For each line of business dealt with a chart of accounts is given, the principal books of first entry are described, together with the most commonly found auxiliary records and primary documents. Each part opens with a brief statement descriptive of conditions in that business and the main points to which the accounts must give attention. For the most part the style is lucid and simple, though here and there the authors have used a phraseology in something other than its customary sense, which causes the reader in places to pause to consider precisely what is intended. In introducing the subject of organizations not undertaken for profit, for example, (page 5) the expression occurs: "The next group, called the public accounting group, . . ." The next sentence indicates that this expression means businesses which commonly account to the public for the funds, such as hospitals, fraternities, social and religious associations, national governments and their political subdivisions.

The book does not attempt to deal with the policy or management aspects of the businesses which are taken up. One is disposed to wish, for example, that the insurance chapters contained more discussion of the important problem of the insurance reserve than is found on page 109, questions of what constitutes an adequate or inadequate reserve, the question of the valuation of the securities which constitute the reserve and so on; but probably such matters are outside the field. When a book deals clearly with the subject to which it addresses itself, we should not complain that it does not deal with something else; but in the case of the explanation of banking operations, for example, which is very well done, one is a little wishful that the authors had made clearer the way in which the banks practically create money for purchasing power in the process of loaning. Many people imagine that a bank loans out only the money which is passed in to the receiving teller as deposits, and in these times it is

so important for the public to understand clearly that the bank creates loans and deposits simultaneously, that one wishes this matter might be clearly explained whenever opportunity arises.

T. H. Sanders

Harvard University

Security Speculation. John T. Flynn. (New York: Harcourt, Brace & Company, 1934. Pp. xii, 332.)

Whatever one may say of Mr. Flynn's writings, at least they are interesting, and although this new volume is written in a more restrained manner than one expects from Mr. Flynn, it is no exception to the rule. "Security Speculation" is a keen, biting, carefully organized attack on practically all phases of speculation as practiced on the New York Stock Exchange.

The term "speculation" is used to refer to speculation in securities only. There is no attempt made to include commodity, real estate, or any other types of speculation, and security speculation ". . . is an operation in which one buys or sells securities with the design to make a profit out of the changes in the market price of such securities." On the basis of this definition ". . . we will examine the services which the exchange performs and inquire whether security speculation, even when short of its abuses and excesses, adds any useful or indispensable function to our financial, commercial and industrial machines." Although the author speaks of examining the services performed by exchanges, this is not to be interpreted as a restriction of his inquiries. One of the major points at issue is the supply of funds used in exchange speculation; another is the supply of securities which serve as chips in the game of speculation. Both of these points are analyzed. And when the author addresses most of his criticisms against the New York Stock Exchange, he does so because this exchange is ". . . the largest, the most highly organized, in every sense the most intelligently managed and guarded. It serves as a pattern for all the lesser exchanges, though few equal its efficiency and character."

In order to criticize security speculation one must understand how it is carried on. First, who are the parties involved? The author quotes President Whitney's statement that 123,000,000 people were responsible for the wild rise of stock prices in 1929, and undertakes to refute it. Taking figures prepared by Mr. Gardner Means as a starting point, Mr. Flynn arrives, by a series of eliminations, at the conclusion that "Security speculation as understood here is not practiced by more than one per cent of the population. Indeed, it may be nearer one-half of one per cent." With the elimination of large numbers of speculators from the picture, the reasons for great changes in stock prices must lie elsewhere than with the frenzied multitude referred to by exchange officials. The author's solution is: (1) "Most of this speculation is initiated and whipped up by the members of the New York Stock Exchange." (2) "The members of the Exchange themselves personally, and their firms, are on one side or the other of the market in almost one-half of the trades on the Exchange." These statements are not lightly made, but are buttressed by an abundance of statistics unearthed during the recent Congressional investigations.

The only argument advanced in support of exchanges which the author believes can justify their mechanisms is the argument ". . . that security speculation is essential to keeping in flow the needed supplies of capital funds for our corporate industries." "In short, it will be found that the argument is good, indeed relevant, only in so far as it can demonstrate that the practice of speculation is requisite to the financing of corporate enterprise."

In order to test this theory the author has made intensive studies of numerous corporations for the purpose of determining the extent to which these corporations are indebted to the existence of security speculation for their capital. Historically, the railroad was among the early industries financed through the corporate device, yet in 1868 there were only 43 roads with shares listed on the New York Stock Exchange out of a total of 752.

Turning to individual roads, the Northern Pacific may be used to illustrate the author's method, and to support his contention that security speculation played but a small part in securing capital for the railroads. In 1930 the funded debt and capital structure of this company showed: bonds, $331,312,500; surplus $193,207,575; stock $248,000,000. The argument, as developed by the author centers around the common stock, since security speculation is not, to any great extent, concerned with bonds. Of the total of $248,000,000 only $110,000,000 represented actual financing; the balance came into existence through the exchange of securities, etc.

The same situation exists in the steel industries. The total of outstanding stock of seven of the leading steel companies as of December, 1930, was $1,502,715,744. "Of this sum only about $60,000,000 was issued for the purpose of drawing fresh capital funds into the steel industry."

The same methods are employed in studying the automobile and other industries and the same situations revealed. From these studies the following conclusion is drawn: "The argument about the financing of new industries being helped along by speculation on exchanges is, of course, utterly insupportable. As to old-established industries which are already listed, it is true that financing by stocks is sometimes employed and that it ought to be employed more. However, financing by means of stock in established industries is usually impeded rather than helped by speculation."

A second argument advanced in support of security speculation is that professional speculators ". . . make it their business to study industrial conditions and the earning powers of securities. This

expert regulation of prices by the speculator is necessary to guide the small investor."

This argument implies that professional speculators study corporations and place prices on stocks ". . . which price the market follows." This the author emphatically denies. It is admitted, however, that prices are fixed by speculators, but this is not a service on behalf of the small investor—rather it is the reverse, for the reason that small investors have surplus funds to invest during periods of prosperity and at such times prices are invariably established too high.

One of the reasons why prices are driven to abnormally high levels by speculators lies in the "floating supply" of securities in the market. Instances are cited such as that of the Case (J. I.) Corporation with less than 90,000 shares in the market in 1931. Yet this limited number of shares ". . . became the basis of sales of 13,777,300 shares in 1931, which means that they were turned over 153 times. This is, of course, the work of speculators."

The claim is advanced that exchanges, as they now operate, ". . . are devices for creating excessive debts — claims upon property and business enormously in excess of the benefits conferred on business by those particular claims."

The argument thus advanced runs as follows: (1) common stocks are usually sold privately and only to insiders such as organizers and promoters; (2) common stocks are then distributed to the public through the machinery of exchanges. The case of the United and Foreign Securities Corporation is cited as an example. The capital of $30,000,000 was raised by selling first preferred stock with a bonus of 250,000 shares of common to the public, and a private offering of $5,000,000 second preferred and 750,000 common was placed with a group of bankers for $5,000,000. The stocks held by the bankers were then listed and unloaded on the public. The common stock, for which nothing was paid, eventually sold at $50 per share.

One of the chief objections to this practice, in the author's opinion, is that ". . . the rise of the market price has, beyond all question, the effect of putting upon the mind of the management a pressure to produce earnings sufficient to afford a normal yield upon market valuation." This conclusion is one of the few advanced without proof of any sort.

Finally, a volley of criticism is fired at manipulative devices such as pools, short-selling, and the specialist. Manipulation and such evils as "making markets" have grown ". . . out of that unsound theory of liquidity. . . . There is no reason why the holder of a capital investment should be able to find for his investment immediately and without delay or loss another owner."

Short-selling is condemned. "The conclusion which is justified on short-selling is that it does not operate as a depressive influence on the market as a whole and has little permanent influence on the long-term price of a stock; that on the other hand it performs no useful service in the market; that it is purely an instrument in the hands of the pool operator, the floor trader and the speculating specialist; that it can be used to hammer down the price of individual stocks and is used for that purpose; that it could perform a useful purpose in checking inflationary price rises if it were not for the fact that in practice the technique of trading has taught the broker that the time to apply short-selling to the market is after the stock has begun to decline as a result of other forces."

The author has made a careful analysis of the operations of specialists as revealed by recent investigations. The specialist ". . . performs a useful service so long as he is acting as a broker . . ." However, specialists trade for themselves, as well as act in the capacity of brokers, and there is no economic justification for this practice. Mr. Flynn recommends that the functions of the specialist be taken over by the exchanges themselves.

This volume is a remarkably penetrating study. In a few places the reviewer feels that the author may have been unduly selective in his choice of statistics and illustrations. A few conclusions are reached which, so far as the material in this volume is concerned, are but mere assertions. The subject of security speculation has been carefully restricted and a wealth of statistics have been introduced to support some rather startling conclusions.

Considered as a whole, "Security Speculation" represents a sweeping denunciation of many of the trading practices of our stock exchanges, of the manner in which equity stocks are created by corporations, and of the devices used to finance security speculation. Some of the conclusions presented will be readily accepted, but many will be violently criticized. One does not need to subscribe to all of the ideas in this volume in order to appreciate its value as an excellent attack on our present system.

F. P. Smith

Yale University

Simplified Mathematics for Accountants and Executives. Second Edition. Harris D. Grant. (New York: McGraw-Hill Book Company, 1934. Pp. xiv, 434.)

In this book intended for bookkeepers, accountants, executives, and others who must deal with mathematical problems of finance, the author has attempted to avoid the technical presentation of problems which assume a familiar knowledge of algebra and logarithms. He has presented problems solved by arithmetical methods, in order that the ordinary person without technical knowledge might be able more clearly to understand their solution. Throughout the book the plan is followed of first of all defining the various terms used in connection with a certain topic and then presenting a group

of illustrative problems with their solutions, relating to that topic. A wide range of subjects is treated and the field of mathematics of finance is covered in a very thorough manner. However, the reviewer feels that clearness is sacrificed in many places because of the desire for brevity and because of an undue emphasis upon the attempt to present problems in a manner which will make their solutions appear extremely simple. The methods used in many of the solutions are not as clear as might be desirable, nor as simple as they appear to be. Because of the wide scope of the book and the author's intention to make it a practical book in all respects, little attention is paid to the theoretical side.

The countless examples given are in most cases well chosen, and the methods used are in general sound as well as practical. In a few places in the book the choice of method is somewhat questionable because of lack of applicability and because of being apparently the more complex of two alternative methods. However, defects of this nature are very few in number, and do not detract materially from the great practical value of the book.

After defining the common arithmetical terms in the first chapter, the author devotes the second chapter to "Some Common Problems and Their Solution." This chapter includes treatment of problems of percentage, commission, brokerage and stock and bond investment (including valuation of stock rights), proportion, price marking, alligation, trade discounts, storage, and inventory calculations.

The third chapter deals with various situations which require the use of arithmetical and geometrical progressions. Such things as progressive bank deposits, debts paid by instalments, Morris Plan loans, chattel mortgage loans, square root, cube root, and similar problems, are considered.

The next chapter on "Interest and Its Functions" includes the 36 per cent method, the 12 per cent method, annual interest, compound subtraction, interest bearing notes, partial payments, bank discount, and true discount. The chapters following, on "Analysis of Compound Interest and Discount," deals with problems related to that subject, and also illustrates a practical method for making interest tables and explains how to use such tables.

Chapter VI is concerned with the various aspects of annuities. Chapter VII is devoted to a consideration of various types of problems concerned with bond valuation and interest on bonds; while the next chapter deals with sinking fund and amortization problems.

The ninth chapter considers a group of miscellaneous problems and their solution; such as, buying a home on second mortgage, valuing a leasehold, combined life insurance and deferred income bonds, endowment funds, partnership interest and adjustment, and the present value of a wasting asset.

Then follow chapters on "The Average Due Date of an Account," "Building and Loan Associations," and "Depreciation Methods." The last named chapter explains and illustrates the recognized methods of computing depreciation, — straight line method, fixed percentage of diminishing value method, sinking fund method, annuity method, and sum of years' digits method,—and then follows with a discussion of the reason for equalizing annual depreciation and upkeep expenses.

The above twelve chapters were included in the first edition of the book. The thirteenth chapter, entitled "Significance of the Double Entry Bookkeeping Equation," is an added chapter in the second edition. This has been included "with a view to broadening the text and enhancing the value of the book from an accounting standpoint," and the author has intended to explain in this chapter "every detail of the effectual aspects of mathematics as applied to the double entry bookkeeping equation."

The first part of the chapter treats of "balance-sheet comparisons showing differences that effect changes in capital." The author recommends that an auditor in a report to his client, should submit the following statements in addition to those generally presented.

A comparative balance-sheet showing increases and decreases in assets, liabilities, and capital.
Summary statement of change factors that effect changes in capital.
Statement of resources provided and their application.
Summary of working capital.

The writer points out that a "statement of income and profit and loss . . . shows only the profit or loss from operating the business" while a "statement of resources provided and their application . . . shows receipts and expenditures which are general in character." In other words, the latter shows, for example, such items as capital expenditures and capital stock transactions, which are not included in the former. The statement of resources provided and their application is very similar to that one more commonly known to accountants as an application of funds statement.

"Split fiscal periods" are next discussed, and detailed exhibits are given to illustrate methods used. Then attention is given to "comparative profit and loss statements to determine the cause of a fall off in profits." The section "exposition on audit disclosure" points out how various methods of defalcation have been discovered, illustrates working papers used to make adjustments for errors and defalcations, and shows correcting journal entries and corrected financial statements. The chapter is concluded with a treatment of "activities of a receiver in equity as disclosed by the content of a realization and liquidation statement."

Another added feature in the second edition is the inclusion of an appendix which contains "A Treatise on the Extraction of Roots," "Arithmetical Functions of the Digit 1," "Factoring and the

Divisibility of Numbers," "Factors in Hoskold's Tables Analyzed," and "Roosevelt's Home Mortgage Plan." Compound interest and discount tables are also given.

From the above outline of the book, it can be seen quite obviously that in respect to subject matter, the book is very comprehensive. The author, with a background of considerable practical experience, has presented a wide range of topics in a very practical manner. It seems, however, that brevity and attempted simplicity, as well as complete avoidance of theory, are perhaps overstressed in some parts of the book. Nevertheless, it can be said that in general the author handled the various subjects in a capable manner and in such a way that a technical mathematical knowledge is not necessary in order to understand and apply the methods used. This book should be of great practical value to bookkeepers, accountants, executives, and business men.

C. A. Moyer

University of Illinois

Truck Selling, Simultaneous Selling and Delivery in Wholesale Food Distribution. Lars J. Sandberg. (Boston: Harvard University Bureau of Business Research, 1934. Pp. x, 34. $1.00.)

The author defines "truck selling" as simultaneous selling and delivery, and restricts his study to its use in wholesale food distribution. This includes truck wholesalers and manufacturers using truck selling. After pointing out the wide variety of food products in the distribution of which truck selling is used at the present time, he proceeds to analyze the factors which have caused the growth of this particular type of distribution with a view to determining its future possibilities.

The development of truck selling is the outgrowth of a desire for an inexpensive form of specialty selling—a term which the author uses to describe "the practice of limiting the number of products which a salesman sells, in order that he may relate his efforts to individual products." Wholesale grocers are not organized to provide specialty selling, since they must handle hundreds of products in order to achieve low selling costs per unit of product. Consequently manufacturers desiring specialty selling must either use missionary salesmen, resort to direct sale or use truck selling. The economic advantages of the latter type of distribution, are (1) that only one man and only one vehicle are required for both selling and delivery; (2) that only one trip to the retailer is required by this method as compared with two when other methods are used; (3) that the expense of checking and filling individual orders is eliminated, since an individual order requires but a single handling, from truck to store; and (4) that other savings are to be found in the elimination of samples, the facilitation of cash sales, and the simplification of control records.

The economy of truck selling depends basically upon conditions which permit accurate anticipation of demand. As the major economies of truck selling come in the physical handling of the goods, these economies quickly reach a point of diminishing returns when the truck salesman carries insufficient quantities of some goods and consequently has to make a second trip, or when he carries greater quantities than customers will order, thus incurring unnecessary expense in handling and trucking. In general, truck selling is most adaptable to products of small bulk in relation to value in which frequent sales are necessary but whose demand is fairly stable.

Truck wholesalers who have exclusive sales rights for the products which they sell secure an average gross margin of 20% of the selling price to retailers. Manufacturers could probably secure distribution through regular wholesale grocers without specialty selling for a 10% to 15% gross margin. Although insufficient data are available for a comparison of truck selling with other types of specialty selling, the author feels that the data at hand warrant the conclusion that "a grocery manufacturer cannot justify distribution through truck wholesalers unless his products require specialty selling services, the advantages of which compensate for the higher cost."

Dr. Sandberg is to be commended for carefully pointing out the limitations of the subject which he treats. Truck selling is but a small segment of the general problem of distribution. The total amount of sales by this method is not large, nor does the future promise much in the way of growth. Yet the study of small segments such as this one, and the piecing together of the results will eventually give us a clearer and more accurate picture of the problems involved.

E. D. McGarry

University of Buffalo

Federal Tax Course. Walton Accounting Series. (Chicago: Walton Publishing Company, 1934.)

The authors of Walton Federal Tax Course have stated the purposes of their textbook in the following language:

> First, to present in logical sequence a thorough discussion of the fundamental principles of Federal income taxation in language easily understood by those not versed in legal phraseology and usages.
>
> Second, to present this discussion in such manner as will continue to merit the phrase by which the work has been referred to in the past, "the most teachable text on the subject."
>
> Third, to make the text material and references to the Law, Court, and Board of Tax Appeals decisions, and Bureau rulings, sufficiently exhaustive to enable income tax practitioners to use the course as a guide in the preparation of income tax returns and in the handling of tax cases be-

fore the Treasury Department and the Board of Tax Appeals.

Apparently the course is designed for the layman as well as the expert. This review is an attempt to determine how well this ambitious objective is fulfilled by the contents and method of presentation of the text.

As to the first purpose, it may be fairly said that the subject is presented in a logical manner and is relatively free of legal phraseology. Beginning with a discussion of the concept of income, the various classes of income are then described and exemplified in detail. This is followed by a discussion of the deductions which are allowed under the law. The remainder of the course, which constitutes the largest part of the text, describes the application of the fundamentals of income taxation to the various groups of taxpayers, such as individuals, corporations, partnerships, estates, trusts, and nonresident aliens. By way of illustration actual income tax forms, completely filled out, are presented and described.

As to the second purpose perhaps the most helpful description is to say that the make-up of the book is similar to that of other Walton publications. It consists of a series of lectures which are replete with examples and problems, to which answers are appended. These, however, may be removed from the loose-leaf binding when the book is to be used for classroom purposes. The entire discussion is preceded by a copy of the Revenue Act of 1934, printed in such a manner that changes from the previous law are clearly discernible.

It is doubtful whether the text achieves the third, and final purpose for which it was written. The book is undoubtedly useful for a beginner, and will serve effectively as a reference book for practicing accountants or instructors who require occasional information concerning specific points of income tax procedure. This value is enhanced by an index which is especially useful since it is sufficiently detailed to make discussions of specific points of income tax law readily accessible. But the expert who deals exclusively in income tax procedure will need, in addition to this text, other and more current sources of information; the assumption may fairly be made that he is already thoroughly familiar with the fundamentals of income tax law. His task is to keep abreast of the changes in the law as they occur through new legislation, Treasury decisions, Bureau rulings and Court decisions, and to apply the law to a multitude of different business situations, all of which cannot possibly be covered in a text of this scope.

This, however, would be true of any text, and it must be admitted that the book goes far toward attaining its ambitious objectives. It really does appeal to many groups of people, and is surprisingly up-to-date, a valuable feature in view of the drastic changes brought about by the Revenue Act of 1934.

C. L. BURRILL

Harvard University

International Raw Commodity Prices and the Devaluation of the Dollar. **M. T. Copeland. (Boston: Harvard University, Bureau of Business Research, 1934. Pp. v, 69. $2.00.)**

The most valuable in the new publication by Professor Melvin T. Copeland is the collection of prices of sensitive commodities on leading world markets for the period 1926-1933. Well prepared charts permit an easy comparison of the variations of prices on four, five, and sometimes six leading world markets during this eventful period for such commodities as: copper, lead, zinc, tin, silver, sugar, rubber, coffee, silk, cotton, wool, butter, and wheat. As long as prices were related to gold in all the major markets they showed similar and almost simultaneous changes with a general tendency to decline long before 1929. But since 1930 and particularly since 1931, variations of prices on separate markets diverge from the general tendency, reflecting the influence of monetary factors in individual countries. In such a manner, charts published by Professor Copeland make it easy to follow the influence upon the raw commodity prices not only of the devaluation of the dollar but also of the departure of Great Britain from the gold standard and of the monetary inflation in Japan. However, the main purpose of the author is to study the influence of the monetary policy of the United States by comparing the course of prices of selected sensitive commodities in domestic markets with the course of prices of the same commodities in foreign markets. The author gives special attention to the influence of the gold purchasing plan announced by the President of the United States on October 22, 1933. For that reason prices for the last three months of 1933 are given in weekly averages while for earlier periods they are given in monthly averages.

Accepting many of the conclusions of Professor Copeland on disturbing effects of the devaluation of the dollar and particularly his conclusion that the prompt and *permanent* revaluation of the dollar is the step most "urgently needed for safeguarding a return of real prosperity" we are obliged to take exception to some of his conclusions. He says that his analysis shows "that the process of raising prices by inflationary measures is a slow one." However, his charts show that the sensitive prices of speculative raw commodities reacted rapidly on the departure from the gold standard. The development of prices in America in 1933 for these commodities shows that they rather anticipated the devaluation of the dollar. The speculation anticipating the devaluation of the dollar in some cases went too far and a reaction was inevitable. The announcement of the gold purchasing plan was made during such reaction and for that reason it is difficult to detect its influence on prices apart from their reaction on the previous too fast rising caused by speculation.

The analysis of Professor Copeland ends on December, 1933, just in the midst of the monetary experiment. It would be desirable that the price

series published in this study would be extended farther and analyzed with greater thoroughness.

V. P. TIMOSHENKO

U. S. Department of Agriculture
Washington, D.C.

Business Organization and Combination. Lewis H. Haney. (New York: The Macmillan Co., 1934. Pp. xxii, 684. $3.00.)

This is the third edition (revised) of one of the outstanding texts in the field of business organization and control. In the main, the organization of the book has not been materially changed from that of previous editions. All the chapters, however, have been altered in the course of this revision. Additional chapters include a critical examination of the Anti-Trust Law Legislation in 1933 and a postscript chapter on "Social Control vs. Business Organization and Combination in 1933." In the Appendix the author has added sections entitled: "Trade Association Sales Talk," "Trade Practice Conference," "The Sugar Institute" and the "Textile Code (1933)."

The arrangement of this standard text follows the subsequent outline. The text is divided into four main divisions and the appendix. The first division introduces the general subject and outlines the evolution of the classes of business organization correlated with the progress of industrial society. The second section indicates the historical development and economic and legal characteristics of the various forms of business organization. The individual proprietorship, the partnership, the joint stock company, the corporation, the business trust, trade associations and agreements, pools, combination trusts, community-of-interest organizations, the holding company and the complete consolidation are given, on the whole, adequate treatment. The third division presents the life history of a typical business corporation. The author reviews the functions of promotion and underwriting, shows the relationship of its financial problems to the security markets and finally indicates the problems and practices of reorganization. The final chapter of this division describes the development and organization of the International Harvester Company. The last section points out the evils and causes of our corporate and trust problems, sets up a program of remedies, outlines and interprets the anti-trust legislation and finally relates this legislation to the fundamentals of the New Deal and social control of business. The Appendix presents typical contracts and agreements of various forms of business organization.

The claim of the author that the contribution of his book lies in its "careful definition of terms and accurate classification of forms" is by no means an exaggeration. The text is outstanding in this regard. Furthermore, few, if any other, books in its field make such a thorough application of economic principles to the fundamentals and practices of business organization and control. Organization charts and balance-sheets at pertinent points assist the reader in visualizing the problem and practices under study. Too few books in this subject make use of these devices for illustration and visual explanation. In general the book is well documented.

On the other hand, a critical examination reveals the following deficiencies to the reviewer: (1) Insufficient attention is given to the various forms of partnership and their pertinent economic and legal characteristics; (2) No recognition is given to the value of the income statement to show sources of corporate income and support of security issues; (3) The description of the inter-relation and purposes of the balance-sheet and income statement is unsatisfactory and approaches the inaccurate (p. 304); (4) Inadequate treatment is given to the types and characteristics of corporate securities. It is doubtful whether the full significance of the indicated corporate and trust practices and the proposals for their remedy may be gained without this fundamental presentation; (5) Little or no attempt is made to make use of the results of the study of the Federal Trade Commission on the financial practices of utility corporations; (6) Probably the most serious objection is that even though the book is a 1934 edition, the work of the author was completed in 1933. It is unfortunate, for example, that the functions and work of the Securities and Exchange Commission is given only cursory mention.

In spite of these suggested inadequacies of treatment the book has few peers within the field of business organization and control and its points of strength make it a notable addition to the key-book in any library on economic and financial subjects.

DANIEL BORTH, JR.

West Virginia University

Problems in Accounting. Windsor A. Hosmer, Thomas H. Sanders, and Arthur W. Hanson. (New York: McGraw-Hill Book Company, Inc. 1934. Pp. xvii and 463, $4.00.)

This book is the fourth of those made possible by the Arthur Lowes Dickson Fund for Accounting Research at the Harvard Graduate School of Business Administration. In both content and make-up this work bears a general resemblance to *Problems in Accounting Principles* (R. G. Walker and P. B. Coffman), the first formal work resulting from the Dickinson Fund. Some half dozen of the one hundred and ten cases presented are described as adapted from data appearing in the earlier volume.

There are five principal sections in the book: An introduction to accounts, balance sheets, and operating statements; Bookkeeping; Accounting for current assets and current liabilities and an introduction to special journals; Accounting for permanent assets, funded debt, and proprietorship;

and Accounting for income and expense. In each section are presented cases made up of data resulting from actual business operations or summarizing an actual business situation. Business practices peculiar to an organization whose accounts or statements are under the scrutiny of the student and those likely to be beyond the ken of one not having special knowledge of the field under discussion are described by the authors. In general, these descriptions appear to be adequate in supplying such additional background as is essential.

The "book is planned for the use of students with or without previous acquaintance with accounting." It progresses in an orderly manner and provides ample opportunity for the showing of resourcefulness on the part of the student. Opinions will differ as to the adequacy of the discussion of bookkeeping procedure and simple statement preparation. One should not, however, overlook the fact that this work is a *text* and that it is designed to aid the student in acquiring a knowledge of accounting sufficient to his needs in understanding the use of accounting data in the solving of business problems. It has long been hoped that the material on bookkeeping procedure might be limited, in the introductory accounting course, to that undefined irreducible minimum essential to the students' progress in accounting. Many who are interested in accounting instruction will agree that the authors have here taken a long step toward that goal.

Undoubtedly the student "*without* previous acquaintance with accounting" will find himself at a distinct disadvantage in the earlier chapters if a goodly number of his fellows are "*with* previous acquaintance." This is probably true of any system or manner of accounting instruction for it is unlikely that a course can or should be conducted in such manner as to destroy the value of a student's previous experience in the field. To those who believe that the inexperienced student's introduction to accounting *per se* might well deal with something less formidable than the financial statements of the American Telephone and Telegraph Company (page 5), Montgomery Ward and Company, Inc. (page 8), and Allis-Chalmers Manufacturing Company (page 12), it may well be answered that these statements should serve to impress upon the student both the importance and the magnitude of the work in hand. That he will be more intrigued by these statements than he would be by those of the proverbial I. M. Madd, Hatter, is undeniable.

No detailed description of the cases presented seems to be warranted in this review. A sampling is undesirable because of the heterogeneous nature of the cases. In general the cases are presented clearly and concisely. Numerous well-designed "leading questions" stimulate the student in his effort to satisfy his curiosity. The authors have "sought to preserve in the cases the vividness of the experience in which they arose and *the significance of the situations to the enterprises concerned.*" (Reviewer's italics.) In no small measure they have succeeded.

S. G. Winter

University of Iowa

Glossary of Mediaeval Terms of Business—Italian Series 1200–1600. Florence Edler. (The Mediaeval Academy of America, 1934. Pp. xx, 430. $6.00.)

Because the business activities of the Middle Ages covered a wide area and were conducted in divers languages, the present volume, as the sub-title implies, is a part of a projected larger whole. No one book of convenient size could include the whole glossary.

The main section of this book, about 300 pages, is a glossary of the more technical words and phrases found in Italian business records dating between the years 1200 and 1600. The words chosen refer for the most part to accounting (about 200 terms), banking, exchange, buying and selling, barter and credit, insurance, transportation, custom duties, commodities, weights and measures, kinds of trades and classes of artisans. Not only are the words briefly defined and cross-referenced, but each is shown in its context in quoted excerpts from documents of the times. This feature should have great value for the close student since he may occasionally be able to find shades of meaning from the context which defy concise expression in a formal definition.

The sources from which the terms and excerpts have been drawn are for the most part merchant's letters, personal diaries, commercial contracts, law statutes, old account books and bookkeeping manuals. These materials are assembled in the collection of Bardi and Peruzzi documents in Florence, Italy, the Datini Archives in Prato, Italy or in the Selfridge Collection of Medici Manuscripts on deposit at Harvard University. In preparing the work the author has sought the criticism and advice of many scholars both here and in Europe. It is evident therefore that no pains have been spared to make the work accurate and useful.

The book is a most acceptable foundation for future studies in business history—a sadly neglected field of knowledge in spite of the fact that ours is a country where business occupies a very prominent place in the thought of the people. Research in medieval business documents has long been discouraging because of numerous obsolete words and meanings and baffling abbreviations. To make matters worse, many dictionaries omit much of the vocabulary of commerce, industry, banking and accounting. For these reasons a wealth of source material about early business transactions and industrial activities which is buried in old mercantile account books has not yet been adequately explored. With a new tool available in the form of this glossary it is to be hoped that scholars will be encouraged to bring to the rest of us the means of securing a better perspective of business history.

Criticisms of details from so scholarly a work does not come with good grace from someone deficient in a

real knowledge of the Italian language. Yet the reviewer is impelled to raise the question whether certain phrases of the fourteenth and fifteenth century such as *mettere in saldo la ragione*, and *saldamo nostra ragione gienerate* (vide p. 255), and certain such terms as *saldo* and *bilancio* are not somewhat too freely rendered when linked with the modern term "balance sheet." A more literal translation would tend to relate the process in question to the modern "closing the books" rather than to the subsequent, and separate, "preparation of the balance sheet." The term most closely conveying the latter thought is *Inventario*. In the glossary this word is too closely defined as "inventory of mercantile stock or private possessions."

"Balance sheet" now means specifically, though of course not exclusively, the statement of assets and equities derived from complete double entry records. That is, the term balance sheet is generic with "balance account," that summary of account balances remaining after the closing process has eliminated the nominal accounts for incomes and expenses. Since it appears that this practice was not yet a part of the bookkeeping processes discussed, the use of "balance sheet" cited above was perhaps too great a modernization to carry the clearest picture of the earlier stages of accounting evolution.

One other point of small moment. In the extracts from the old ledger entries the term *de dare* is sometimes translated "must give" and sometimes "owes" or "debit." It may be doubted whether the three are equally desirable terms even though unquestionably somewhat synonymous. "Must give" seems much more expressive of the intent of the entry which was: "We have given him thus and so and therefore eventually he must give back." In a similar manner "must receive" seems a better rendition for *de avere* than "give credit." The term *fa debitore* (make debitor) is probably the term most closely approaching our word "owe." For such early entries *de dare* and *de avere* could easily be translated consistently throughout as "must give" and "must receive" without misleading the reader.

Besides the glossary itself the book contains seventeen pages of source references and sixteen pages of lists of classified terms. The latter include: Florentine money, linear, dry and liquid measures, weights, taxes and duties and groups of business terms for profit, interest, sales, remittances, credit instruments, storage, shipping, etc. Here too the industrial activities of the time are compactly summarized in a classified list of terms showing in sequence the processes of treating wool and manufacturing woollen cloth.

There are also nearly one hundred pages of appendices, which give valuable information regarding Medici partnerships, Medici accounts and bookkeeping methods, and the Florentine woollen industry. It is this section which keeps the book from being purely a reference book of medieval terms for here are several word pictures of scenes from industrial and bookkeeping history.

The appendix dealing with Medici bookkeeping will be especially appreciated by accounting students for it presents for the first time in English an extended report of the bookkeeping methodology of the century immediately preceding the appearance of Paciolo's treatise in 1494. A few German scholars (Sieveking 1902, Penndorf 1933) and a few scholars in Italy (Ceccherelli 1913, Corsani 1922, Bensa 1928) have reported studies of Florentine bookkeeping history based largely upon the Datini archives. But their works do not come easily to our hand and we are grateful for this study in English of material from the Medici collection.

Appendix II is a compact but fascinating picture in forty-four pages of a half century of evolution of bookkeeping methodology. The gradual transition from mere memoranda paragraphs to systematic double entry bookkeeping, which Corsani and Penndorf found so clearly indicated in their study of the account books in the Datini archives for the last half of the fourteenth century, is also reflected in this study of the Medici records for the first half of the fifteenth century. Many translated examples of the ledger accounts are given in this connection.

The oldest ledger (1406–1418) is a typical memorandum record of debts and payments. The first half of the book contains paragraph memoranda of debts due from wool spinners for advances; repayments in cash or work are noted below the respective charges. In the last half of the book are recorded the debts owed to others and the discharge payments made. A ledger of 1417–1428 also lacks impersonal accounts and shows no indication that the postings had been made from books of original entry. Yet there were signs of evolution, for the repayment was recorded on the page opposite the original debt rather than below. This arrangement of showing subtraction by opposition and of closing an account for transfer forward by entering the balance on the smaller side was part of the "method of Venice."

The next ledger, 1431–1434, is arranged like the ledger of 1406–1418 but a profit and loss account and petty expense account appear in the first section among the personal debtor accounts and in the creditor section are the accounts of the partners' investments. Another characteristic of the subsequently completed double entry bookkeeping found here is the posting reference. There are a few cross references to the contra account, such as profit and loss, where the counterpart of the entry in question was to be found (probably the earliest closing entries) and quite systematic page references to the books of original entry from which the ledger items were posted. These books of original entry were not like those described by Paciolo [Were his waste-book and journal further characteristics of the "method of Venice"?] but were a cash book, a wage book, and a combined purchase and sales book.

Soon further progress is seen; the ledger of 1441–1444 not only shows debits on left pages and credits on right pages, posting references, etc., but in addition, since the partnership was to be dissolved, a fairly complete statement of assets, debts and capital is written on the last page of the book. This we would call a single entry balance sheet for none of the impersonal accounts

therein come from the ledger. The inventory of merchandise is added to the accounts receivable (cash had all been distributed earlier). From this total the sum of the accounts payable and partners' capital is deducted to give the calculated profit which is shown divided between the three partners. It is not clear from either the text or the illustration what treatment was given the profit and loss account found among the debtor accounts. It probably served only as a sort of general expense account and was not "proved" by the profit calculated by the statement of assets and capital. Bad debts were recognized but, it is interesting to observe, they did not enter the statement of assets or figure in the calculations of profit. Instead they were separately divided among the partners in their profit and loss sharing ratio. Debts receivable and payable and merchandise were also divided in a similar manner. In this way the three-year partnership was dissolved and liquidated to the satisfaction of all concerned.

Bookkeeping progress since that time seems to have been mainly in the direction of expressing all adjustments more completely in the ledger. When we look at modern standard cost accounting practices the same line of evolution is seen still developing. Shall we ultimately see the financial budget also recorded in ledger accounts?

The ledgers of the fifteenth century usually had a statement of assets, liabilities and capital in the later pages like the one described. But they had very few impersonal accounts to carry the details of profit making. Hence the importance of the "single entry balance sheet." The ledgers of the sixteenth century, however, frequently show a Cloth Account which contained debits for wool and dyestuff purchased, wages of workmen, utensils—which made a total representing the cost of cloth manufacturing—and credits for the sales of cloth, the balance being carried to the profit and loss account. There was no entry for inventory but much of the cloth produced was shown as sold to the individual partners and leads to the guess that the account technic of carrying an inventory forward in the goods account was not yet fully recognized.

The use of wage books, purchases and sales books, and the attention given to cost finding in textile manufacture, remind one of similar, though in some respects less successful, attempts in F. W. Cronhelm's *Double Entry by Single*, London, 1818.

The availability of this excellent glossary and the hints given in the appendices of the many interesting things hidden away in these old documents encourages one to hope that someone will soon present us with an extended analysis of the early history of bookkeeping and the steps by which double entry emerged. When this shall have been done within a framework of surrounding economic ideas, industrial conditions and legal rules, the result should be an introduction to business history which would be epoch-making in the literature of business.

A. C. Littleton

University of Illinois

Accounting in the Zenon Papyri. Elizabeth Grier. (New York: Columbia University Press, 1934. Pp. xiii, 77 $3.00.)

Zenon, a Carian Greek, was in 256 B.C. made general manager of the estate and affairs of Apollonios, the chief finance minister of Ptolemy Philadelphos. He was very methodical in his work, keeping most minute accounting records of the matters in his charge. He was very careful to file these records, and in 1915 A.D. over a thousand of his papyrus documents were unearthed near the site of the ancient Egyptian city of Philadelphia. The book here reviewed is the result of Miss Grier's critical study of many of these papyri, both published and unpublished, and of other materials of research in this special field which might aid in their interpretation.

Zenon's records "reveal the various tasks incidental to the conducting of official duties, to the running of the household of an important public official, and to the organization of a gift-estate which was run on a large scale" (p. 4). Apollonios' estate was of great size. Its management involved such operations as stone-cutting, the building of irrigation works, the clearing and cultivation of land, the care of vineyards and the disposal of their products, the distribution of seed to employees, the rental of herds, the loaning of money and the entrusting of estate funds to members of the "establishment." Apollonios sometimes went "on tour" either for private mercantile purposes or as a public official, or in both capacities at the same time. This competent study of Zenon's detailed accounts give much information about the economic life of Egypt in the third century B.C.

Dr. Grier's book is very informing as to the accounting methods employed by a Greek professional estate-manager in ancient Egypt. Miss Grier finds no evidence of the use of a "double-entry system." Yet there was a double system of accounting. This was because there was in Egypt a "double economy," a barter or goods economy and a money economy combined. "There was not enough money," the author says, "in gold and silver to meet the requirements of the fairly recent money economy of the state" (p. 37). Zenon's accounts contain only one mention of gold, a case of a bank deposit. The regular units of exchange were silver and copper drachmas, and it was in terms of these that Zenon kept his "money accounts" ("*argyrikoi logoi*"). But there were also, and predominantly, for the barter economy, "grain accounts" ("*sitikoi logoi*"), or more generally and more accurately "commodity accounts." There were accounts with such commodities as grain, wine, oil, perfumes, pickled fish and meats, dyes, bricks, and sheep and other livestock. These commodity accounts, kept in terms of appropriate physical units of measurement (as "kotyles" of oil and "artabs" of wheat) strongly resemble the device of the so-called "modern" perpetual inventory. The exactness with which each act of using up a commodity was recorded suggests something approaching a cost accounting system. This phase of the record keeping was carried so far that Zenon could ascertain from his accounts

exactly how many rolls of papyrus were issued to the bookkeepers each day.

Zenon's accounts were kept in Greek, not in the demotic, that is, the language of the people. By virtue of this fact the author considers that her book is "the starting point for a more comprehensive study of the development of Greek and Roman accounting" (preface). She sees in Zenon's methods of record keeping a close similarity to those employed in Greece in the fifth and fourth centuries B.C. Hitherto knowledge of the earlier Greek accounts and records has come from epigraphical and literary sources. Now this knowledge has been valuably supplemented. Miss Grier has prepared an appendix in which over fifty Greek words and phrases used by Zenon have been rendered into their modern technical equivalents. We have here well exemplified the fact that a knowledge of the technical phases of financial and other business records may be a most useful tool of scholarly research, even in fields somewhat removed from the market places of the twentieth century.

STANLEY E. HOWARD

Princeton University

America's Capacity to Consume. M. Leven, H. G. Moulton and C. Warburton. (Washington, D. C.: The Brookings Institution, 1934. Pp. xi, 272. $3.00.)

This volume is the second in a series of four growing out of a study of the "Distribution of Wealth and Income in Relation to Economic Progress." The purpose of the investigation as a whole is to determine whether the existing distribution of income in the United States among various groups in society tends to impede the efficient functioning of the economic system.

The hypothesis has frequently been advanced that the small incomes received by the masses of the population provide in the aggregate so meager a purchasing power for the potential output of our productive establishment as to be a potent source of economic difficulties. Such a conclusion is not unnaturally suggested by the fact that even in good times some of our plant capacity and labor force is idle, while in periods of acute disturbance a substantial part of our productive capacity stands unutilized, resulting in a simultaneous great restriction of consumption—the familiar "want amid plenty." In the light of this situation we find people asking the question: If a larger percentage of our annual income were somehow made available to the purchasers of consumptive goods, would not business managers find it profitable to utilize existing capital equipment more fully, thereby giving to the masses of people higher standards of living, and at the same time promoting a steadier and more rapid rate of economic progress? This thought, moreover, evidently underlies certain phases of the policy now being pursued by the federal government.

This second volume studies the flow of income arising out of our productive operations. It is this income which determines the capacity of the people to purchase the consumption goods which are annually produced, and also to provide the savings which are essential to the formation of new capital. The investigation divides itself into three parts, as follows: Part I treats first the amount of the national income resulting from the productive activities of society and its increase during the first three decades of the twentieth century. Part II considers how those who receive the national income dispose of it, i.e., the allocation of expenditures among the major types of consumers' goods, and also the amount and character of American consumption as a whole. It is then indicated how the amount of income that is spent by the several income groups compares with the amount which is saved, and the bearing of this upon the division of the aggregate income as between spending and saving. Finally, the question is raised whether, during the period from 1900 to 1930, there was any tendency for the proportion of the aggregate income of individuals that is set aside as savings to increase relatively to the amount which is spent for consumption purposes. In Part III, entitled "The Relation of Consumption and Production," the findings are related in a broad general way to the conclusions reached in the preceding volume. The extent to which the magnitude and character of the demand for consumption goods would be modified by comparatively slight increases in the purchasing power of the lower income groups is indicated and these consumptive potentialities are compared with the existing productive capacity of the nation. Finally the bearing of our analysis upon certain important current issues, such as the fear of persistent over-production and consequent demands for restriction of output, the amount of leisure that is compatible with high standards of living, and the necessary length of the working day are discussed. The conclusions reached in Volume II are only tentative and judgment is reserved for Volume III. It appears that the economic developments during the first three decades of the present century have not only increased the ease with which national savings may be made, but have in general speeded up the rate of savings. In the case of individuals the increase in national productivity has manifested itself, with certain interruptions, in a dual tendency toward an increase in the volume of savings relative to consumptive expenditures; the rise of incomes in general has made it possible for the population as a whole to save a somewhat greater proportion of their income; while the fact that there has been a greater increase in incomes received by the upper than by the lower classes has tended automatically to increase the aggregate volume of savings. The tendency has been especially marked during the decade from 1919–1929.

ROBERT WEIDENHAMMER

University of Minnesota

Auditing Theory and Practice. Fifth Edition. Robert H. Montgomery. (New York: The Ronald Press Company, 1934. Pp. viii, 772. $6.00.)

The present edition, which "has been revised and rewritten to a considerable extent," is nearly 100 pages shorter than the fourth edition. Developments affecting the work and responsibilities of the profession are reflected in the changes which have been made. Whereas

in the prior edition the balance-sheet audit was first treated by itself and later four chapters were devoted to the detailed audit, in the present edition the balance-sheet and the detailed audit are now considered together. Under the various balance-sheet and income account titles the reader is given an opportunity to compare the work to be done in both types of audit. This procedure should be far more effective than the earlier method. The responsibilities of auditors, in which considerable developments have occurred since 1927, have been given additional consideration, and all writings in the field from 1927–1934 have been considered for inclusion in the new edition. It should be noted that "the book is intended first and foremost for the practicing accountant."

A comparison of the tables of contents in the two editions shows few major changes other than those mentioned above. A reading of the text, however, reveals numerous citations of facts and legal decisions which bring the book up-to-date.

Mr. Montgomery has again made use of assistance of others connected with his firm. As is usual with his books the style is easy and clear. The volume is a distinct addition to the literature of the field.

Arthur W. Hanson

Harvard Graduate School of Business Administration

Budgeting. Prior Sinclair. (New York: The Ronald Press Company, 1934. Pp. iii, 438. $5.00.)

This book is a very helpful work on the subject of budgeting. After the early enthusiasms which followed the "discovery" of business budgeting some twelve or fifteen years ago, there have in a number of cases been reactions tending to reduce the amount of attention given to the subject in business practice and in business literature. But more mature reflection has convinced business men that there is something in it; the problem, as with all tools of management, is to extract its advantages at the minimum of cost and effort. In the case of budgeting this means coördinating it effectively with other accounting and statistical work of the company.

The book is mainly one of procedure and method. It deals fully and succinctly with the various steps which must be taken in applying budgetary principles to manufacturing and merchandising businesses. The author in his preface says, "The purpose of this book is to give an organized presentation of budgeting principles and practice as the information heretofore published on the subject has been scattered and fragmentary." And further, "It is believed that the book offers for the first time working methods sufficiently detailed to permit of ready adaptation to the needs of the small manufacturing or trading concern, as well as to the needs of large, highly developed organizations. . . ."

In working out these plans the author has made extensive use of other writings which are quoted in illustration and amplification of his ideas. This doubtless is included in what is referred to in the preface as aiming at "comprehensiveness."

The general plan of the book is interesting. After two chapters of an introductory character four chapters are given relating to the budgets for the business as a whole. These are entitled, respectively, the Master Budget, Financial Budget, Estimated Balance Sheet, and Estimated Profit and Loss Statement. In other words, the objectives of budgeting are presented first in the shape of their effects on the entire business. Then follow ten chapters in which departmental and functional budgets are dealt with in detail, all of these being parts of the general company budgets previously presented.

Early in the book the author very properly emphasizes the fact that budgeting is part of the planning or management; it is indeed either an integral part of management or nothing at all. When the author says "The budget does not deprive executives of freedom of action . . ." (p. 21) he raises what has been something of a stumbling block. One prominent business executive made the observation that the budget is a very dangerous instrument, by which he meant that unless business managers are careful the budget *may* limit their freedom of action. Or if it does not do that it may create a feeling that the problems of the year have been solved when the budget has been approved, and thus lull the executives into dangerous indifference. In other words, like all other tools of business control it is as effective as the hand which wields it can make it.

It is to be feared that the insistence that the budget as finally approved shall always "show a satisfactory outcome" (p. 104), though a consummation devoutly to be wished, is not always possible. If the forecasts are to be useful they must above all things face the probable future with candor, and there are many industries which could not, by any stretch of the imagination, have forecast a happy outcome during the last three years. This does not mean, however, that wise planning cannot relieve the situation; it may very well reduce the losses, though conditions may make a net profit impossible.

In the chapter on the Budget Manual (Chapter 19), and another on Budget Reports and Charts (Chapter 21), the results of the budget operations as they are realized from time to time are discussed. Here a picture is given of many ways in which the work of the budget department may be turned to good account. This material in general will be found helpful and convincing, though here and there an example is of a type to raise the perpetual question as to whether all this work is necessary, and is paying for itself. In the case (p. 360), for example, where the budgeted salaries have been exceeded because an assistant foreman had been added to the staff, it will occur to many that this is the sort of fact which will be known to all concerned in advance, and requires no budget procedure to dig it out. The real justification for this sort of thing is the development of information which is new to the executives; the budget must prove itself on this basis. This new information, however, does not all come after the event. Many of those who have had experience with budgets contend that the major advantages are derived from the careful planning and forethought which must be

devoted to the preparation of the budget. In this way undesirable conditions are frequently remedied before the budget period is begun.

In Chapter 20, Profit Realization Chart, the sort of chart commonly associated with the name of C. E. Knoeppel is discussed at length in its various forms with examples worked out as to their construction and interpretation. Certainly every business man ought to have a clear view on these matters of the point where profit begins, and the contributory factors, with respect to his own business.

A copious index adds usefulness to a distinctly useful book.

T. H. Sanders

Harvard Graduate School of Business Administration

Federal Securities Act Procedure. J. K. Lesser and J. A. Gerardi (New York: McGraw-Hill Book Company, Inc., 1934, Pp. xi, 388. $4.00.)

This volume is an interpretation of the Securities Act of 1933 as amended, written by an accountant and a lawyer. "It is to the elucidation of methods of procedure under the Law, in the language of the accountant and the business executive, that this treatise is dedicated."

In many respects "*Federal Securities Act Procedure*" is a mere re-statement of the Act. However, this work combines under single headings the various sections of the Act bearing on particular questions. This is not a discussion of the Act section by section but a synthesis of the different sections and pronouncements of the Federal Trade Commission. For example, Chapter 4 discusses the registration of securities and includes seections from six sections of the Act and several rulings of the Federal Trade Commission.

There is not much law included in this study for the obvious reason that the Act has been in effect only a short length of time. Some cases have been cited, particularly those in which the Federal Trade Commission has figured.

The accounting sections of the Act have been emphasized and while much of this section is a re-statement of the Act the brief discussion of the duties of accountants under the Securities Act is excellent.

This volume will not enable one to forecast the future of the Securities Act. There are few recommendations for amendments. The authors are content with the conclusion that the Act is ". . . an understandable and workable instrument" and interpret the language of the law as it stands.

F. P. Smith

Yale University

Federal Tax Handbook, 1934-1935. Robert H. Montgomery. (New York: The Ronald Press Company, 1934., Pp. xiv, 1158. $10.00.)

In reviewing this latest addition to the long series of handbooks by this eminent and authoritative author, attention is directed to the preface which contains some pointed criticism of the trend in Federal tax legislation in the United States during the past twenty-five years, as contrasted with that of Great Britain during the past quarter of a century. Specifically the author criticizes the prohibition of consolidated returns; the denying of the right of taxpayers to deduct losses on sale or exchange of property in which the profits of 1928 and 1929 are reflected, and on which profit the taxpayers paid taxes; the intentional confusion, in a well planted propaganda to influence and mislead public opinion, of tax evasion with tax avoidance and the implication of moral turpitude on the part of those who, in an instinct of self-preservation, did those things which the law allowed in order to reduce their tax liability. He criticizes these as evidence of the retrograde record of our tax legislation as contrasted with Great Britain's continuous progress in fairness, flexibility, and satisfactory administration.

The Handbook consists of three parts. The first part consists of twenty-five chapters, and deals with the income tax as it affects individuals, partnerships, estates and trusts, and corporations. The second part consists of two chapters dealing with payments, assessments, refunds, and penalties. The third part consists of three chapters dealing with the estate tax, gift tax, capital stock tax, the excess profits tax, tax on transfers to avoid the income tax, dues, and initiation fees.

The material in the Handbook is most conveniently indexed. In the appendix there is a table of law sections arranged numerically keyed up with the page or pages on which the sections are discussed. In the back of the book are indices to Articles of Regulations for Regulations 45-62-64-70-77-78-79-80; to Treasury Departments rulings; to United States Board of Tax Appeals Decisions; and to court cases.

The Handbook consists of 1020 pages of text material which is the concentrated essence of Federal Income Tax law. A reader should be able to find readily in this volume the answer to almost any federal tax question with the controlling section of the statute, the related regulations, and the leading opinions, rulings, and decisions. Obviously, in a volume of 1020 pages dealing with such an extensive subject, an exhaustive discussion of every possible subject is an impossibility.

The Handbook, however, does give an authoritative answer to an unbelievable number of tax questions, and, for one who desires to delve further into a given question, the citations furnished in the text save much time. In addition the opinions of the author on points of law which have not been finally adjudicated are extremely helpful, and are respected both within and without the Bureau of Internal Revenue.

James V. Toner

Boston University

The Flexible Budget. John H. Williams. (New York: McGraw-Hill Book Company, Inc., 1934. Pp. xv, 288. $2.50.)

The structural elements in the flexible budget are (1) an organization, clearly defined in fact and well charted on paper; (2) a complete list of the ledger accounts, in which each account is assigned to a column marked with the name of the managing executive responsible for it; (3) a complete income statement, with

the items similarly allocated, but without subdivision of any item; (4) a data sheet, in which each item is expressed as (a) a constant or minimum element, plus (b) a proportionate or variable element; (5) the last named item, which gives the "flexible" quality to the plan, is expressed as a rate per $1000 of sales, and is found by dividing the difference between maximum and minimum sales into the difference between the related amounts of expense for the item in question; (6) the budget itself, in which income and expenses are listed for (a) forecasted sales, at budgeted rates, (b) actual sales at budgeted rates, (c) actual sales at actual amounts, (d) variations between (b) and (c). Strictly speaking, only the *rates* are budgeted in advance; the budget *amounts* are set up only at the end of the period, when the volume of sales is known. These various stages in the development of the budget form the subject matter of the principal chapters, and are illustrated by a series of exhibits at the end of the book.

The spirit and attitude of the work are reflected in the following sentences, selected almost at random:

"This book is written with that purpose. It is for general executives. . . . It shows budgeting as a tool of management. . . ." (Preface)

"The prevailing idea that budgeting is complicated and hard for anyone except those familiar with accounting to understand is due to the fact that for some inexplicable reason most of the literature on the subject is written as if for accountants and emphasizes its accounting aspects." (Pp. 2, 3)

"Taylor's concept of management now dominates industry." (P. 13)

"An accountant cannot of himself know how expenses should be grouped to reflect responsibility." (P. 41)

"No Distribution of Overhead So Far As Budget Is Concerned." (P. 34)

"Should it be desired to know the value of work in process and finished products including overhead, as has been suggested in connection with tax returns bank statements, etc., the overhead can be added *in a few minutes*, (reviewer's italics) whereas, on the other hand, if the overhead were included no one executive would be responsible for the manufacturing cost as shown on the budget and in the ledger." (Pp. 82, 83)

There is a tendency throughout the book to emphasize a little too sharply the lines between (a) financial accounting, (b) cost accounting, (c) standard costs, (d) budgeting, (e) forecasting. These concepts deal largely with the same subject matter. Both from the point of view of management results, and of economy in operation, there is much to be gained by deriving all these aspects from the same body of records and data, by suitable organization and modification.

T. H. Sanders

Harvard Graduate School of Business Administration

A Program for Unemployment Insurance and Relief in the United States. Alvin H. Hansen, Merrill G. Murray, Russell A. Stevenson and Bryce M. Stewart. (Minneapolis: University of Minnesota Press, 1934. Pp. viii, 201. $2.50.)

This book presents a comprehensive plan for unemployment insurance and relief as suited for the specific needs of this country. It represents the final results of various studies made by the Employment Stabilization Research Institute of the University of Minnesota.

Among the various recent contributions to this problem, this book stands out through its combination of practical and theoretical approach. Especially Part 4, contributed by Dr. A. H. Hansen, on *The Investment of Unemployment Reserves and Business Stability* explores new ground. Unemployment reserves, if carefully handled, may assist in the stabilization of business activity; if carelessly handled, may actually aggravate business fluctuation.

The stream of income that functions as purchasing power in the market is, under our money and credit economy, subject to violent fluctuations. In boom times the income stream is augmented beyond what is justified by the productive process through (1) the creation of an excessive volume of bank credit, (2) intensive utilization of existing bank credit, and sometimes (3) the disgorging of previous hoardings of cash. In times of depression the income stream is drained off by (1) the diversion of some part of it into the extinguishment of indebtedness to banks, (2) less intensive utilization of deposits (credit hoarding), and at times (3) actual cash hoarding.

The hoarding and dishoarding of money and credit, the extinguishment and creation of bank credit are all the results of innumerable individual decisions. It is the aim of monetary and credit control to contrive schemes (discount policies and open market operations) which, by exerting pressures of one sort or another, may induce individuals to refrain from those actions, so intimately bound up with the rise and fall of new investment, which cause fluctuations in the income stream. But this procedure is only partially effective. It may, therefore, be possible and desirable to offset individual hoarding and dishoarding of money and credit by collective and managed hoarding and dishoarding and to offset individual extinguishment and creation of bank credit by collective and managed creation and extinguishment of bank credit.

If there is to be a leveling down of purchasing power from the boom period to the depression period, it can only be accomplished by checking the creation of new purchasing power in boom times or by offsetting these new funds by withholding some part of the purchasing power from entering the market; and by creating new purchasing power in times of depression or bringing withheld purchasing power into the market. It is essentially by this yardstick one must measure the effect of any proposed administration of unemployment reserves upon the stabilization of purchasing power.

There are three faucets through which an increased stream of purchasing power may flow and so restore the depressed income of a community: (1) through producers, in consequence of increased business activity; (2) through consumers, in consequence of the spending of hoards (cash or other forms of savings);

and (3) through the government, in consequence of increased expenditures (such as emergency benefits to the unemployed or public works) financed out of the creation of new credit. Unemployment insurance reserves fall in the second category. They are "hoards" of a kind, which in the depression period are put actively to work in the commodity market.

The accumulated reserves might be administered by any one of the following methods:

1. The funds might be placed in deposits
   a. With commercial banks
   b. With Federal Reserve Banks
   c. With Saving banks
2. The funds might be invested in commercial paper and short-term obligations of the Federal government purchased in the open market.
3. The funds might be invested in United States government bonds
   a. Purchased and sold in the open market
   b. Purchased from and sold to the Federal Reserve banks
   c. Purchased from and sold to the United States Treasury
4. The funds might be kept in whole or in part in money hoards.

After discussing these different methods, Dr. Hansen tentatively recommends that one-third of the funds might be deposited with the Federal Reserve Banks and two-thirds with the Savings banks.

ROBERT WEIDENHAMMER
University of Minnesota

Government Experimentation in Business. Warren M. Persons. (New York: John Wiley & Sons, 1934. Pp. xi, 268. $2.50.)

In these days when the full impact of "New Deal" ideas collides with the time honored conceptions of classical economics, a well documented history of certain older "new deals" is of great merit, be it to buttress the reasoning of the Tories or to refine the technique of the Progressives. Dr. Persons discusses with apparent unbias the outcome of ventures of Federal and state governments into the realm of business enterprise. Certain of such experiments have been successful, such as the New York Port Authority, but the overwhelming evidence indicates that the cards are stacked against the success of democratic government in competition with private enterprise. No attempt is made to lay the blame at any particular doorstep; the record is expected to speak for itself.

ROBERT WEIDENHAMMER
University of Minnesota

The House of Adam Smith. Eli Ginzberg. (New York: Columbia University Press, 1934. Pp. viii, 265. $2.75.)

Actuated by the suspicion ". . . that the general approach had never been fully appreciated." Mr. Ginzberg has carefully examined ". . . the relevant material which was published between 1688, year of the Glorious Revolution, and 1776, the year in which the Wealth of Nations appeared" for the purpose of determining the perspective and objectives of Adam Smith's great work. Part One is devoted to the reconstruction and interpretation of the Wealth of Nations the author of which was ". . . praised by his enemies, and condemned by his friends. A series of historical accidents can account for this paradox. During the mêlée the spirit of Adam Smith was lost, but perhaps it is not too late to recapture it."

Under the title, *Merchants and Knaves* the author accounts for the ". . . solicitude and concern which the government evidenced for the mercantile class . . ." an attitude with which Smith had no sympathy. Since there was some likelihood that ". . . if the intrenched position of the commercial and the industrial interests could be undermined, agriculture would be greatly benefited." Smith felt that nothing could be lost by the effort. But he believed that labor was the most neglected stratum of society and he found in this a further incentive for the attack upon privilege. Not only were the farming class and labor the victims of the mistaken and vicious doctrines of the mercantile classes but these doctrines hampered the growth of the wealth of the nation, Even the ". . . colonial policy . . . was dictated by the allwise merchants," for the large trading corporations ". . . were hard pressed by the merchants who dealt on their own account." Hence Smith directed his attention ". . . expecially toward those institutions which enabled a small minority to enrich themselves at the expense of the large majority." for he held that the ". . . commercial class which directs in large part the economic processes of a country is the only group which . . . has interests divergent from those of society." Corporations . . . prevented prices from falling and were therefore responsible for the country's slow advance.

Included in the scope of Smith's attack were the intellectual classes and institutions of his time, for Smith regarded Oxford and Cambridge as sanctuaries of ". . . exploded systems and obsolete prejudices." Moreover the spiritual leaders threw in their lot with the ruling classes and Smith did not escape clerical criticism. As for this form of privilege as well as others, laissez faire might prove a remedy for many of the evils attached to religious doctrines ". . . could be eradicated, if there were many small sects instead of a few powerful institutions." The author believes that Smith found inspiration in Voltaire. The church was on the side of the merchants and the latter stood in the way of governmental reform so dear to Smith, hence he must proceed with the attack but it must be done in the Scotch manner, i.e., circumspectly. However his method was radical for he favored a social order in which regulation in behalf of the masses would be unnecessary. The result was a doctrine in which the central thought was freedom, so dear to the hearts of Britains. But it was to be freedom under the laws of an incipient science later to become political economy.

Once his system was promulgated it was seized upon by "False Prophets" and Smith became, unwittingly,

the "... economist of capitalism," a status not only misleading but quite wrong. In support of this view, Dr. Ginzberg analyzes the "... economic organization which the Wealth of Nations presupposes ..." He is thus led to discuss the dating of the power revolution, so important to the evaluation of Smith's work, and concludes that the revolution must have taken place after its publication. Hence Smith could not have been the economist of capitalism. Moreover, he was not the founder of the science of economics. Yet the author admits that the founders "... considered themselves his pupils." Among them Ricardo was foremost, but his failure "... to appreciate Smith was very probably the result of his insufficient cultural training." Smith dealt with dynamic economic forces, while Ricardo's concepts were essentially static. Malthus, the champion of the *status quo*, was actuated by a "fear psychosis," while J. S. Mill believed that Ricardo "... had solved certain technical problems for all time." In any event the founders were false prophets so far as the gospel of Adam Smith was concerned.

There follows a chapter, "Hell Called Heaven," in which the author shows how Smith's ideas were made the intellectual bulwark of the evils developed by the rising capitalism. In this connection Dr. Ginzberg does valuable service, for he explains that "... the afflictions of the laboring poor was due in large part to the fear which the new machinery engendered in the captains of industry"; the expensive machines might not pay for themselves unless employed 24 hours a day. And so it came about that the use to which Smith was put "... by the avaricious capitalists resulted in the reformers' antagonism toward him." In developing this thesis the author takes former President Hoover as the typical modern exponent of Smithian laissez faire employed to defend a system which Smith would doubtless condemn. But it cannot be said that the choice is particularly a happy one. At any rate Mr. Ginzberg points to the incongruities arising from an effort to defend modern capitalism with a philosophy arising from a very different economic order. So the objective is justifiable even if the method is not.

In the closing chapter, "Flesh and Spirit," the author restates his position. Smith resented the meddling of the state; he preferred a natural order and he understood *natural* "... to mean the causal sequences which could be anticipated if disturbing influences were absent." Hence, he was no Physiocrat. His conception to the natural order was quite different but his use of the term involves him somewhat, for "... the reformers of the eighteenth century were ... likely to appeal to the natural order." To bring out the meaning of these the author analyzes the views set forth by Pope Pius in his encyclical on Christian marriage and divorce and finds therein much to admire and little to accept.

In conclusion, it should be said that Mr. Ginzberg has done a commendable thing, for doubtless there is much lip service to laissez faire in defense of an order which has done so much to destroy it. Furthermore, there is no doubt some popular confusion as to Smith's place in economic thought and it is probable that many economists freely detach him from his background. But surely no student who is familiar with the economic life of Smith's time could fail to see the dangers thus involved. If there be such they can profit from reading this volume for it shows the need of a correct perspective. In addition there are helpful citations to appendices and footnotes. So, everything considered, the work of Mr. Ginzberg constitutes a welcome addition to the voluminous Smithian literature and unique as well, for no previous writer had devoted an entire volume to the task which he had in mind. The main thesis, is, on the whole, well supported, for doubtless Smith has been wrested from his setting. But is not that same thing being done to every great mind whose thinking has impressed posterity or who has developed a system of thought conveniently adaptable to situations of which he never dreamed?

E. A. Kincaid

University of Virginia

Security Analysis. Benjamin Graham and David L. Dodd. (New York: McGraw-Hill Book Company, 1934. Pp. xi, 725. $4.00.)

"This book is intended for all who have a serious interest in security values," but it is not addressed to the complete novice. As the authors suggest, the scope of the work is much broader than its title may suggest, for it deals "... not only with the methods of analyzing individual issues, but also with the establishment of general principles of selection and protection of security holdings." They also admit that they "... have stressed the technique of discovering *bargain issues* beyond its relative importance ... because in this activity the talents peculiar to the securities analyst find perhaps their most fruitful expression." But the governing aim has been to "... make this a critical rather than a descriptive work."

In Part I, Survey and Approach, the authors promptly explain that they shall regard the period from 1927 to 1933 as an extreme laboratory test and by no means a "... proper norm by which to judge the future of investment." In addition they consider "the 'common stock insanity' ... a monumental example of a sound principle grievously misapplied," i.e., the common-stock theory of investment. Accordingly they disagree with Chamberlain that common stocks are not an investment at all, since they generally give a good account of themselves as investments when selected by the tests of an investment rather than those of a speculation. Furthermore, the "... concept of 'earning power', expressed as a definite figure, and the derived concept of intrinsic value, as something definite and ascertainable, cannot be safely accepted as a *general premise* of security analysis."

Since "... the failure properly to distinguish between investment and speculation was in a large measure responsible for the market excesses of 1928-29 and the calamities that ensued," the distinction is given careful consideration and the conclusion is reached that "An investment operation is one which, upon thorough analysis promises safety of principle and a satisfactory

return. Operations not meeting these requirements are speculative." The discussion then passes to "Fixed-Value Investments" in the course of which four principles for the selection of the fixed-value type are elaborated. The first of these asserts that safety is not measured by lien but by ability to pay. According to the second, bonds should be bought on a depression basis, and third, it is unsound to sacrifice safety for yield. Finally, definite standards of safety must be applied. The authors then proceed to work out and apply them to actual corporations in a way that is highly effective. Thus, the ratio of market value of capital stock to the total funded debt is recommended as "... a standard element in the procedure of bond selection ...." The procedure in this and other instances rests upon the "... controlling principle that the bond investment is a *negative art*." Again, "... an investment preferred issue must meet all the requirements of a good bond, with an extra margin of safety to offset its contractual disadvantages." Incidentally, it is brought out that "... some better methods should be developed for protecting the bondholder than the usual prolonged and expensive receivership." Furthermore "Under present practices the trust companies which assume these (trustee) duties are not trustees at all—but rather 'agents of the bondholders'." The related discussion of these subjects is highly valuable. The authors also suggest that in event of default of covenants, "... voting control be transferred to the bondholders." Moreover, "The standard arrangement should give every preferred and every common issue the separate right to *elect some directors under all circumstances*." Again, since corporation laws permit the *withdrawal* of substantially all of the capital and surplus after the loan has been made," it is essential that the maintenance of an adequate amount of junior capital be insisted upon. These and other highly significant facts characterize the able treatment of the entire section on Fixed-Value Investments.

Part III, Senior Securities with Speculative Features, is characterized by a number of principles which should be observed in their purchase. Then comes The Theory of Common Stock Investment, Part IV, in which the authors undertake to make up for the deficiencies resulting from that fact that the "... prewar theory (is) obsolete and the new-era theory exploded ..." The new-era theory that "The value of a common stock depends entirely upon what it will earn in the future," is characterized as "... simply old-style speculation confined to common stocks with a satisfactory trend of earnings." Thus the authors are led to point out the radical fallacy in Smith's *Common Stocks as Long-term Investments*, namely, that there is no method of establishing a logical relationship between trend and price. This and other material makes the entire treatment of the "Theory of Common-Stock Investment" highly valuable. Then comes Part V, Analysis of the Income Account, in which there is much material that only wide experience in security analyses could provide, including examples of "tricky accounting," mistreatment of depreciation, an able discussion of long-term depreciation as a form of obsolescence and an analysis of price-earnings ratios. A striking feature of this section is the contention that "... avoidance of bonded debt by the strongest industrial companies has ... produced results demoralizing to investors and investment policies in a number of ways."

The discussion then passes to Balance-Sheet Analysis. As for book value, the authors hold that no rules may be laid down as to its relation to market price, but there are a number of significant principles brought out in the analysis of liquidating value, particularly with reference to stocks selling below liquidating values. In this connection it is said that "... the spectacle of a company overrich in cash passing its dividend, in order to impel desperate stockholders to sell out at a ruinous price, is not pleasant to contemplate." Under the topic, Other Aspects of Security Analysis, much significant material is brought out. Thus, "Modern financing methods are not far different from a magician's bag of tricks" and among these tricks is the use of stock options as a part of the underwriter-promoter's compensation. The discussion of modern forms of pyramiding, the discrepancies between price and value, market analysis and security analysis should also be mentioned. Indeed, these authors touch not one phase of the entire treatment in which they do not contribute material that is vital and significant from the standpoint of the teacher of finance, the investor and the speculator. In this statement one should also include the appendix, for here will be found, among other matter of value (Note 3), "A partial list of securities which deviate from the normal pattern." The reviewer knows of no other such list in print. Here also is a critical analysis of Dr. Rodkey's monograph on "Preferred Stocks as Long-Term Investments."

Without the slightest hesitation, the reviewer pronounces this volume the best thing of the kind in print. Not all that it contains is new, but the treatment includes present-day corporations under very recent conditions. However, the volume should not be used as a text in a course except where the students previously have been given work in corporation finance, the economic aspects of investment and speculation and, accounting, if possible.

E. A. Kincaid

University of Virginia

Principles of Accounting, Volume II. Advanced. H. A. Finney (New York: Prentice-Hall, Inc., 1934. Pp. xii, 825. $5.00.)

Since in the first volume of this revised edition Professor Finney dealt chiefly with the corporation, actuarial science, the balance sheet, and income statement, this second volume contains several of the topics formerly treated in Volume I. Partnerships, which formerly had divided treatment in the first volume, now begins the second volume with five chapters placed together, an obvious improvement. Following are two chapters on Venture Accounts, closely akin to the preceding topic. Then, after a chapter on Insurance, come

a series of chapters dealing with the business in trouble, entitled The Statement of Affairs, Receiver's Accounts, Realization and Liquidation Account, and Statement of Realization, Liquidation, and Operations. The next ten chapters deal with a business and its relations with branches and other companies. Foreign exchange, Estates and Trusts, and new chapters on Budgets, Public Accounts, Bank Accounting, and Stock Brokerage complete the volume of over 800 pages. Questions and problems, arranged by chapters, are all at the end of the book and occupy over 200 pages.

The rearrangement of the topics is a real improvement. Some of the topics omitted from this edition of *Principles of Accounting* now appear in Finney's introduction to *Principles of Accounting*. The revision is thorough, more extended treatment being given to some topics and less to others as compared with the earlier edition. In appearance the books have been considerably improved by the publishers.

Arthur W. Hanson

Harvard Graduate School of Business Administration

UNIVERSITY NOTES

University of Florida

Mr. Fred C. Ward, instructor in accounting, resigned December 1 to accept a position with Haskins and Sells at Newark, N. J. Mr. M. B. Cogburn has been appointed to fill the vacancy.

University of Georgia

Mr. L. B. Raisty, C.P.A., received his doctor's degree from the University of Texas this past year.

Mr. H. M. Heckman was elected Chairman of the Georgia State Board of Examiners of Public Accountants.

University of Illinois

Professor A. C. Littleton has been awarded the scroll by the Grand Chapter of Beta Alpha Psi, national honorary accounting fraternity, for the most noteworthy contribution to accounting literature during the past year. Professor Littleton was thus honored for his book "Accounting Evolution to 1900." Mr. Littleton has been on the University staff since 1915. He received his Illinois C.P.A. in 1919 and his Ph.D. in 1931. From 1919–1922 he was assistant dean of the College of Commerce.

University of Kentucky

Professor Robert D. Haun is introducing this next year a new course in "Analysis of Financial Statements." Mr. Haun will address the April meetings of the Louisville and of the Memphis chapters of the National Association of Cost Accountants on the topic of "Uniformity in Accounting."

A new combined course in engineering and business is being developed, to be called Industrial Engineering. Seniors in the College of Commerce are continuing this year their association to secure placements for seniors on graduation. In the past three years the organization has placed all but three of its members. The annual manual of the association "Bargains in Brains" will soon appear.

University of Montana

Mr. C. N. Mason, instructor in accounting and assistant registrar, has resigned to accept a position in the Federal Forest Office. Mr. Roger Johnson, accountant in the University office, has taken his place.

A state employee is sponsoring a bill to give a C.P.A. without examination to any state employee after five years of service. This would make the Montana C.P.A. certificate without standing in any other state. A similar bill conferring certificates on employees in the state bank examining department was passed by the last legislature but was declared unconstitutional by the Supreme Court.

College of the City of New York

Leave of absence for the spring quarter has been granted to Mr. John R. Byers, instructor in accounting, to enable him to accept a position as director in the Mortgage Insurance Department of the Federal Housing Administration at Washington. Leave was also granted to Mr. L. G. Bryngelsson, lecturer in accounting, to pursue work toward his doctorate at Columbia.

Mr. Frank A. Dunn and Mr. Leo Rosenblum have been appointed to fill these vacancies. Professor George M. Brett, head of the department of accounting, is chairman of the college section of the Commercial Education Association of New York City. He led the discussion at the November meeting on the topic of balance sheets.

Dr. John Jaffe, instructor in accounting, has just finished his book on "Labor Cost Records—Their Forms and Preparation."

Ohio University (Athens)

Professor C. M. Copeland, for 41 years head of the School of Commerce and its founder, retired in June 1934. His place has been taken by Professor A. H. Armbruster, formerly acting dean at the University of Pittsburgh. Mr. Armbruster will have charge of the courses in finance.

Revisions of the commerce course are being made eliminating major and minor requirements and substituting "fields of specialization." Wider choice of electives is also being offered to students.

University of Pennsylvania

Dr. William D. Gordon, professor of accounting, who has served for four years as Secretary of Banking of the Commonwealth of Pennsylvania went out of office in January. Mr. Gordon has accepted the presidency of the Bankers Bond and Mortgage Company of Philadelphia.

Princeton University

Mr. Frank T. de Vyver, who has for several years taught accounting and corporation finance in the Department of Economics and Social Institutions at Princeton, has recently received his doctor's degree.

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